

Chapter 46 – The effectiveness of Ofgem’s warnings

46.1 During the development and early implementation of the regulations, Ofgem commented on the drafts provided by DETI, see also earlier chapter 14 of this Report. The following section considers how effectively Ofgem communicated issues that it identified regarding the interpretation of the regulations as well as if, and how, it followed up to ensure that serious warnings it had given were heeded.

Legal review and interim cost controls

46.2 Ofgem produced a very detailed analysis of the legal risks embodied in the draft NI RHI regulations drawing on issues it had already identified and communicated to DECC following its review of the GB RHI regulations. This was given to DETI on 4 November 2011. The document was produced by Faye Nicholls, then an Ofgem lawyer. The Inquiry has referred to this document as the ‘Ofgem November 2011 Legal Review’.²³⁴⁶ It included suggested remedies to potential defects in the NI RHI scheme, for instance the need for a clear definition of ‘heating system’.

46.3 DETI did not take the steps that might have been expected with regard to the Ofgem November 2011 Legal Review – it was not shared for some months with those whom DETI Energy Division had tasked to work upon the draft regulations. Mr Bissett from Arthur Cox, DETI’s external legal advisers on the regulations, did not receive it until four months later in March 2012.²³⁴⁷ Nicola Wheeler from the Departmental Solicitors Office, who was charged with providing internal legal advice to DETI on the regulations, told the Inquiry that the November 2011 Legal Review was never given to her.²³⁴⁸

46.4 Similarly, there is very little evidence of any meaningful follow-up by Ofgem with DETI on the issues raised. Five months after the provision of the November 2011 Legal Review, in April 2012, Ofgem lawyer Marcus Porter did ask internally whether DETI had taken on board the numerous comments previously made by Faye Nicholls.²³⁴⁹ However, at an internal Ofgem meeting also attended by Mr Porter on 22 May 2012, it was still unclear to the participants whether DETI had even been sent a copy of it – Mr Avis took an action to check with his colleague, Catherine McArthur.²³⁵⁰ Having received confirmation that DETI had received the November 2011 Legal Review, Mr Avis then flagged to Ms McCutcheon of DETI that Ofgem had offered these comments to DETI and Ms McCutcheon agreed to look back through the detail that Ofgem had sent.²³⁵¹

46.5 When Mr Hutchinson of DETI sent through the amended regulations to Ofgem on 13 June 2012 he wrote a covering note with a general reference to the November 2011 Legal Review:

“Your legal team have previously seen a copy of these regulations and made comments. As discussed with Catherine previously, these regs largely reflect the GB RHI regs however are amended to cover specific issues with the proposed NI scheme, namely the tariffs and banding. We are aware that DECC intend to

2346 OFG-205301 to OFG-205350

2347 TRA-02885 to TRA-02886

2348 TRA-02822

2349 OFG-205446

2350 OFG-03281

2351 OFG-03311 to OFG-03312

make legislative changes to the GB RHI in the near future however it would be our preference to closely follow their existing regs and then make necessary amendments in the future once DECC’s legislative programme is clearer.”²³⁵²

46.6 In advance of their teleconference on 26 June 2012, Ofgem sent DETI back a copy of this more recent draft of the regulations marked with Mr Porter’s comments and proposed amendments.²³⁵³ Although these did reflect the potential inclusion of DECC’s interim costs controls and some reflections on State Aid issues, the Inquiry notes that none of the comments or changes Mr Porter made related back to the critical points Ofgem had raised in the November 2011 Legal Review, like the need for a definition of ‘heating system’.²³⁵⁴

46.7 In the Ofgem internal minutes of the teleconference with DETI on 3 July 2012 issues relating to regulation 23 and State Aid are recorded together with an action for:

“Ofgem Legal to send a note to DETI spelling out our concerns with Regulation 23 as soon as possible.”²³⁵⁵

46.8 The Inquiry notes that this issue appears to have been important enough to minute and to write to DETI about, but again no reference is made to any of the issues from the November 2011 Legal Review.

46.9 Mr Hutchinson stated to the Inquiry that in the year following the Legal Review, and in the run up to the launch of the NI RHI scheme, there were no issues at all where Ofgem came back to him, as the person responsible for the regulations, to say that some form of an amendment or addition or change was needed.²³⁵⁶

46.10 Evidence to the Inquiry indicates that the effectiveness of Mr Porter’s approach to warnings was questioned both externally and internally. Mr Hutchinson said in oral evidence, regarding the 26 June 2012 teleconference, that the point about the wisdom of proceeding with RHI regulations broadly the same as/mirroring those in GB just as those in GB were about to change was made by Mr Porter:

“... to be fair to Mr Porter, I think he did make that point clear, but I think, you know, that was from a legal opinion, and then I think the administrative side of Ofgem, maybe, saw our viewpoint.”²³⁵⁷

46.11 Ms Hepper reflected a similar view in her oral evidence when asked if she meant that Mr Hull and Mr Harnack of Ofgem were not agreeing with their own legal department and were happy for both DECC and DETI to go ahead and ignore the warnings that Ofgem’s legal department was giving. She stated:

“...certainly that was the message we were getting that, you know, DECC went ahead with their regulations. Ofgem were obviously – must’ve been – content with that.”²³⁵⁸

2352 OFG-03398

2353 OFG-03444 to OFG-03487

2354 OFG-205444

2355 OFG-17094

2356 TRA-04883

2357 TRA-02206

2358 TRA-02649

46.12 Despite several attempts to raise internally within Ofgem the issue of DETI following DECC’s example and proceeding with flaws in the regulations and progressing without cost controls, Mr Porter’s views and concerns of the risks this posed to Ofgem were not escalated to the GEMA Board as he wished. The ineffectiveness of this approach is perhaps reflected by Ofgem’s closing submission to the Inquiry which stated:

“...the repeated, somewhat scattergun, attempts by MP [Marcus Porter] to escalate issues through various avenues has caused Ofgem to consider whether there is a separate learning point for Ofgem.”²³⁵⁹

46.13 Dermot Nolan, Ofgem Chief Executive, told the Inquiry with reference to the risks that Ofgem identified at the start:

“But Ofgem did not monitor them. And I suppose you could say did not tell DETI it’d be monitoring them. I accept that too, although I think, fundamentally, Ofgem should have monitored them and should have kept them up.”²³⁶⁰

46.14 The Inquiry noted that there was no mention of the need for cost control in the Ofgem Northern Ireland Summary 2013.²³⁶¹

Concerns about lack of tiering

46.15 In July 2012 Ofgem was involved internally in an exercise to identify any differences between the GB and the then draft NI RHI regulations. During that process Oliver More, an Ofgem E-Serve official with biomass expertise, was asked to consider the draft NI RHI regulations from a biomass perspective. His comments, emailed internally on 20 July 2012, included the following statement about tiering:

“The tiered tariff has proved a good way of reducing the incentive to waste heat in the scheme (i.e. once they have generated beyond the tier threshold, their fuel costs will often be higher than the RHI payments so boilers are only run if heat has a real value). So taking it out increases the likelihood of abuse and heat wastage.”²³⁶²

46.16 Despite this point being made to Ofgem officials on both the operations and legal sides, the warning about the consequences of omitting to include tiering was not conveyed by Ofgem to DETI.

46.17 Mr More’s view was then incorporated into a legal comparison document by William Elliott, a lawyer on secondment in the Ofgem legal department. The relevant section read:

“Under the existing GB Regulations, the existence of a tiered tariff for biomass minimises the incentive for participants to engage in gaming/intentional heat wastage, ensuring that boilers are only run if the produced [sic] is itself of value. This benefit will therefore be lost under the NI scheme.”²³⁶³

46.18 Mr Porter saw the email from Mr More and reviewed the document from Mr Elliott. In common with other sections judged by him to be examples of where “administrative impact was

2359 SUB-01029

2360 TRA-14860

2361 DFE-331065 to DFE-331067

2362 OFG-161309 to OFG-161312

2363 WIT-104878

discussed”, he deleted this warning from the document and the concern was never shared with DETI.²³⁶⁴ This was justified by Mr Porter in oral evidence to the Inquiry on the basis that Ofgem thought DETI would have given due thought to the question and his assumption was that DETI knew what it was doing.²³⁶⁵

46.19 Mr Porter also removed the warning from Mr Elliot’s legal comparison because he thought that it “was more in the nature of a comment” in a document that was trying to identify differences between the two sets of regulations. The Inquiry finds his approach at this time quite inconsistent with his previous dogged insistence that the absence of cost controls needed to be “hammered home”.

46.20 During his oral evidence to the Inquiry Dr Nolan agreed that a warning ought to have been given and that the unwillingness to go back to DETI was only “somewhat understandable”.²³⁶⁶ It was another example of a communication failure.

46.21 To be fair to Mr Porter, who regularly raised issues of risk, the document in question from which the words were deleted was internal and not one that was to be sent to DETI. In addition, a number of other Ofgem personnel had received the same warning from Oliver More, including Lindsay Goater, Sophie Jubb, Keith Avis and Luis Castro. In the teleconference of 26 June 2012 DETI had told Ofgem that the NI RHI regulations would replicate the GB RHI regulations, “although possibly with differences in the tariff structure”²³⁶⁷ an observation which, in its closing submission, Ofgem has said must have been a reference to tiering. However, the Inquiry notes it might instead, or as well, have been a reference to banding.

46.22 Either way, Ofgem took no steps to find out and did not pass on the subsequent warning. Mr Porter agreed in oral evidence to the Inquiry that it would have been a good idea to raise Mr More’s warning that tiering of tariffs minimised the incentive for gaming during the teleconference but his assumption was that DETI had thought about it. He added that:

“Had I thought it was significant at the time, I would probably have said something ... But I don’t think I was looking at it in that way at the time because, as I say, my assumption was that DETI knew what they were doing.”²³⁶⁸

The clear inference is that the warning was not specifically raised.

46.23 While the Inquiry acknowledges all of the points made by Ofgem in its closing submission, nonetheless the Inquiry agrees with the ultimate position taken by Dr Nolan, the Ofgem Chief Executive, that the warning about the absence of tiering, which was an absence that increased the “likelihood of abuse and heat wastage”²³⁶⁹ in the NI RHI scheme should have been given by Ofgem to DETI.

Additional warnings about cost controls

46.24 The Inquiry acknowledges that the Ofgem Legal Review of 4 November 2011 laid out a range of warnings about weaknesses in the draft NI RHI regulations (many were in common with weaknesses in the GB RHI, which was much further advanced). Ofgem gave a strong warning

2364 WIT-104878; TRA-06323 to TRA-06326

2365 TRA-06325

2366 TRA-16364

2367 OFG-22571

2368 TRA-06324 to TRA-06325

2369 OFG-161312

regarding the need to define a ‘heating system’ stating “DETI should add a defined term to ensure clarity” and “it is not acceptable for this to be clarified in guidance.”

- 46.25 As indicated earlier in this Report, the Inquiry accepts that, in June 2012, Ofgem did highlight the risks of proceeding without the interim cost controls that DECC had by that point adopted. However, Ofgem accepted DETI’s assurance that such controls would be introduced at a later stage. On behalf of Ofgem, Dr Nolan conceded in oral evidence that Ofgem ought to have monitored this but did not do so.²³⁷⁰
- 46.26 In further evidence to the Inquiry, some Ofgem witnesses stated that they had continued to warn DETI about the need for cost controls. In particular, Mr John and Mr Poulton said this happened at two face-to-face meetings in Belfast in April and October 2014. The Inquiry received detailed written closing submissions from Ofgem’s representatives on this aspect of the evidence in support of the recollection of the Ofgem officials.²³⁷¹
- 46.27 The first of these two meetings took place on 16 April 2014 and was attended by Mr Poulton, Mr John and Ms Clifton from Ofgem and Mr Hutchinson, Ms McCutcheon and Mr Mills from DETI. Mr Poulton told the Inquiry that he had prepared in advance of the meeting to talk about cost control.²³⁷² He stated that they may also have talked about tiering, but his main recollection was the discussion on degeneration versus other mechanisms. He recalled “quite a focused discussion around cost controls”.²³⁷³ Mr John told the Inquiry that his recollection was that there was a discussion about degeneration at both meetings.²³⁷⁴ However Mr John qualified that evidence by explaining that, in that discussion, Ofgem was simply “laying out the stall in terms of, operationally, what we could do for them” and he accepted that was very different from the warnings that Ofgem had expressed earlier in the context of what was being done in GB,²³⁷⁵ referring to legal challenge and the need to mirror the GB scheme, as in the November 2011 Legal Review and the June 2012 warning about interim cost control.
- 46.28 The only contemporary documentation relating to the meeting of 16 April that was shown to the Inquiry was the detailed note made by DETI.²³⁷⁶ Despite his assertion that he had prepared in advance to discuss the topic and that a focused discussion had taken place, there is no reference in that note to Mr Poulton raising the subject of cost control. The note begins with a list of the main areas of proposed discussion, as suggested by Ms Clifton, and the subject of cost control was not one of the proposed discussion topics then. The document does not contain any reference to tiering of tariffs.
- 46.29 Further, an email sent by Mr John to other Ofgem staff five days after the meeting, listing action points arising from the meeting, did not mention either topic.²³⁷⁷ An email sent by Ms Clifton to Ofgem colleagues the day after the meeting made no mention of either cost control or tiering of tariffs.²³⁷⁸

2370 TRA-14860

2371 SUB-01071 to SUB-01083

2372 TRA-09716 to TRA-09717

2373 TRA-09720 to TRA-09721

2374 TRA-08908

2375 TRA-08931

2376 WIT-08736

2377 OFG-89927

2378 TRA-06669

- 46.30 The second meeting, on 13 October 2014, was attended by Dr Ward, Ms Clifton, Mr John and Mr Poulton of Ofgem and Mr Wightman, Mr Hughes and Mr Mills from DETI. Dr Ward told the Inquiry he remembered the Ofgem representatives saying that Ofgem could readily introduce changes such as degression and tiering. According to Dr Ward, it was not a primary part of the discussion, but it definitely did form part of the meeting.²³⁷⁹
- 46.31 No minute or record appears to have been made of the October meeting although an internal briefing note, by way of preparation, was sent by Mr Wightman to Mr Mills on 10 October.²³⁸⁰ That note contained a summary of key issues to be discussed, which focused upon Ofgem’s administration charges, Carbon Trust loans and the provision of a data sharing protocol, without any reference to cost control or tiering of tariffs.
- 46.32 Mr Hughes described it as the “annual meeting” and he did not recall any discussion at all about tariffs in the meeting.²³⁸¹ He told the Inquiry “I’m not saying Edmund didn’t raise it: he may have done so, but, I mean, I don’t recall it”.²³⁸² When he was later asked further questions by Inquiry Counsel, Mr Hughes said of the October meeting:
- “I’m absolutely certain that meeting did not deal with cost controls...I’m absolutely certain that cost controls weren’t discussed in that meeting. I have no recollection of that at all. And I would have remembered.”²³⁸³
- 46.33 Mr Mills commented upon this issue at a number of points in his first witness statement to the Inquiry at paragraphs 17, 76 and 85-89.²³⁸⁴ He had no recollection of the need for cost controls being highlighted by Ofgem. In his written evidence to the Inquiry Mr Wightman confirmed that the focus of the October meeting had been to agree a change control for Ofgem’s administration costs and he emphasised that, during all his contacts, Ofgem had never once raised concerns over the level of payments that recipients were receiving.²³⁸⁵ Mr Wightman also had no recollection of the issue of cost controls being discussed at that meeting.²³⁸⁶

2379 TRA-06669

2380 WIT-14868 to WIT-14870

2381 TRA-05898

2382 TRA-05898

2383 TRA-08565

2384 WIT-14522; WIT-14536; WIT-14539 to WIT-14540

2385 WIT-17056

2386 PWC-04674 to PWC-04675; WIT-17056

Findings

244. The Inquiry is satisfied that when Ofgem’s Oliver More explained to colleagues in July 2012 that tiering had the known benefit of reducing the incentive to waste heat, and that the effect of the NI RHI scheme not having tiering increased the likelihood of abuse and heat wastage, an appropriate warning should have been passed by Ofgem to DETI. Identifying the problem/risk of the absence of tiering increased the obligation upon Ofgem to ensure that any associated increased risk was properly considered by DETI. In fact, the Ofgem Fraud Prevention Strategy, discussed elsewhere in this Report, purporting to apply to both GB and NI RHI schemes, asserted that the NI RHI scheme had tiering when it did not.
245. As discussed earlier, Ofgem provided a legal review of the draft regulations to DETI on 4 November 2011 where it laid out a range of warnings about weaknesses in the draft NI RHI regulations (many were in common with weaknesses said to be in the GB RHI regulations, which were much further advanced). Ofgem gave, for instance, a strong warning regarding the need to define a ‘heating system’, stating “DETI should add a defined term to ensure clarity” and “it is not acceptable for this to be clarified in guidance.”²³⁸⁷
246. However, the Inquiry has seen no evidence of serious attempts in 2012 by Ofgem to follow up on the issues from the November 2011 legal review. Given the strength with which the warnings were drafted in November 2011, the Inquiry finds that Ofgem should have followed up the omission of DETI to heed these warnings, at a minimum writing formally to flag this to senior management in DETI.
247. The Inquiry has already found that, in June 2012, Ofgem did warn DETI officials about the need for cost controls in the NI RHI scheme. However, the Inquiry finds that the recollection of Ofgem officials that additional detailed/focused discussions of the need for cost controls in the meetings with DETI during 2014 was not supported by the evidence.
248. In its closing submissions to the Inquiry, Ofgem accepted that “Ofgem should have communicated with DETI again once the risks of which it had warned had clearly materialised.”²³⁸⁸ The Inquiry considers this lapse to have been a major failing.

2387 OFG-205444

2388 SUB-01038

