

Chapter 7 – DETI’s initial engagement with Ofgem about RHI

Ofgem’s administration of the GB RHI scheme

- 7.1 The GB RHI scheme was administered by the Gas and Electricity Markets Authority (GEMA), through its executive arm, a non-ministerial government department known as the Office of Gas and Electricity Markets (Ofgem). GEMA is the independent regulator of the gas and electricity markets in GB.⁵⁵² For convenience, the Inquiry proposes generally to refer to ‘Ofgem’ unless the specific context requires reference to GEMA.
- 7.2 For its funding, Ofgem recovers costs through an annualised fee from the licensed companies which it regulates. In addition to its regulatory activities, Ofgem, acting through its dedicated division known as E-Serve, had developed experience of administering a range of energy schemes in addition to the GB RHI scheme, including the Feed-in-Tariff, and Renewables Obligation, which it also administered for Northern Ireland.
- 7.3 The provisions of the Energy Act 2008 which conferred enabling powers for the GB RHI scheme provided a power to the DECC Secretary of State to make regulations, including for the administration of the scheme. The enabling power envisaged the involvement of Ofgem in the administration. The February 2010 DECC GB RHI consultation document⁵⁵³ set out DECC’s belief that Ofgem was the best placed body to administer the GB RHI, which would include it making payments, but also dealing with audit, compliance and enforcement. In its 26 April 2010 response to the consultation the Renewables Advisory Board (RAB) expressed a number of concerns about Ofgem acting as the scheme administrator, as compared to commercial service providers.⁵⁵⁴ These concerns included what RAB said was its belief that while:

“Ofgem would be well placed to act as a regulator of compliance for the scheme, and that this is entirely appropriate and in keeping with Ofgem’s more general role; for it to act as the administrator as well presents a clear conflict of interest as it would be determining complaints about its own performance.”⁵⁵⁵

Nonetheless, the subsequent 2011 GB RHI regulations conferred the administrative functions on GEMA as the ‘Authority’ to fully administer the scheme.⁵⁵⁶

The Ofgem Feasibility Study

- 7.4 In response to the consultation on the NI RHI, in the summer of 2011, concern was also expressed that the NI RHI scheme should be managed locally⁵⁵⁷ and, accordingly, it was initially proposed that the Energy Act 2011 (in which enabling powers for the NI RHI were to be provided) should appoint DETI or NIAUR as the legal administrator of the scheme, with power to transfer functions to Ofgem. That was consistent with the practice adopted in relation to NIRO and NI Renewable Energy Guarantees of Origin (REGO).

552 www.ofgem.gov.uk

553 INQ-20375 to INQ-20461 at INQ-20444

554 INQ-16086 to INQ-16094

555 INQ-16092

556 LEG-00316 to LEG-00318

557 DFE-382415 to DFE-382449

- 7.5 Ofgem had initially been contacted by Mr Hutchinson with regard to its potential administration of the NI RHI scheme in June 2011.⁵⁵⁸ A formal request for Ofgem to submit an outline proposal was then made by Ms Hepper on 11 July, when she wrote to Ofgem stating:
- “Ofgem’s experience in developing and implementing the RHI in Great Britain will be invaluable in the administration of the Northern Ireland scheme given the many similarities in the two incentive measures.”⁵⁵⁹
- 7.6 On 10 August 2011 Ms Hepper addressed a submission first to the DETI Permanent Secretary, as Departmental Accounting Officer, for onward passage to Minister Foster and Dr Crawford, seeking approval for the appointment of Ofgem to carry out a feasibility study, at a cost in the region of £100,000, into the administration arrangements for an NI RHI scheme.⁵⁶⁰ Ms Hepper advised that an appropriate delivery agent was required but that the capability needed to deliver the scheme in terms of technical expertise, people and IT systems was not available in DETI.⁵⁶¹ She further advised that such a feasibility study was an essential piece of work for the future implementation of the NI RHI scheme and provided a draft business case.⁵⁶² The submission also pointed out that Ofgem had a proven track record for delivery of large-scale energy projects and that it had accumulated extensive expertise in GB that could be utilised in Northern Ireland, bringing a significant saving to DETI.⁵⁶³ Minister Foster accepted the submission’s recommendation on 11 August.⁵⁶⁴
- 7.7 The Feasibility Study started in September and on 16 December 2011 Ofgem presented DETI with a report setting out its proposed resourcing requirements in order to complete the development of the NI RHI scheme in partnership with DETI and undertake the administration of the scheme.⁵⁶⁵
- 7.8 Catherine McArthur of Ofgem, the author of the study, explained to the Inquiry that she worked with colleagues across Ofgem to produce her report. The report outlined Ofgem’s proposals to develop and implement the NI RHI scheme noting that the purpose of the study was to:
- “...provide DETI and Ofgem senior management with a detailed understanding of the delivery and ongoing administrative implications of the scheme for Ofgem. This includes an analysis of costs, delivery options, risks and enforcement requirements.”⁵⁶⁶
- 7.9 Significantly, the Feasibility Study specifically listed some 14 assumptions upon which the study was based. The assumptions, Ms McArthur explained, were about setting conditions, so that in the event that circumstances changed, the cost to DETI for Ofgem’s administration would also change.⁵⁶⁷ Ms McArthur told the Inquiry that when she started in September 2011, DETI’s consultation on the NI scheme, and therefore its policy work, was still ongoing. Given the uncertainties about the final scheme which would ultimately be adopted, she was asked by

558 DFE-313725 to DFE-313727
559 DFE-313730 to DFE-313731
560 DFE-143773 to DFE-143797
561 DFE-143776
562 DFE-143777
563 DFE-143776
564 DFE-30436
565 DFE-79758 to DFE-79921
566 DFE-79761
567 TRA-03658

DETI in October 2011 to take the GB RHI regulations as the basis for the study:

“So, when I commenced work on the feasibility study in September 2011, DETI was still consulting on the scheme. We were expecting to have more certainty around what the final policy would be when we received the draft regulations to review, but, when we received them, they were the GB regs basically with the names changed...”⁵⁶⁸

- 7.10 When Ms McArthur and Mr Harnack, then Associate Director of Ofgem E-Serve’s New Scheme Development,⁵⁶⁹ met Ms Hepper, Ms McCutcheon and Mr Hutchinson in Belfast on 2 November 2011, DETI is noted to have outlined some “local political issues” that may impact upon their final policy position, in particular “an imperative to differentiate the Northern Ireland scheme from Great Britain’s”. It appears that that had been the rationale behind the desire to introduce air source heat pumps (ASHPs) and bioliquids from scheme commencement.⁵⁷⁰

The promised Northern Ireland specific independent risk assessment

- 7.11 Section 2.14 of the Feasibility Study was headed ‘Fraud Risk’ and confirmed that Ofgem had undertaken the study on the assumption that the level of fraud risk was the same in Northern Ireland as in GB. That risk was to be reassessed during the development stage following an independent risk assessment to identify key areas of risk including any local factors that might require a different approach to that taken in GB.⁵⁷¹
- 7.12 Section 5.17 of the Feasibility Study agreed that Ofgem’s independent risk assessment would “inform the development of a Fraud Prevention Strategy to address the risks specific to Northern Ireland.”⁵⁷²
- 7.13 The Feasibility Study was updated on 1 November 2012⁵⁷³ at the time of the scheme launch. In the updated version, at section 1.8,⁵⁷⁴ it was again stated that the assumption that the level of fraud risk for the NI RHI was the same as the GB RHI would be re-assessed during the development phase following an independent risk assessment to identify key areas of risk to the NI RHI scheme, including any local factors that may require a different approach to the GB RHI. Further, at section 10.3 of the guidance published by Ofgem and DETI in November 2012 Ofgem indicated that it would develop a detailed fraud prevention strategy for the NI RHI.⁵⁷⁵
- 7.14 In the event such an independent risk assessment was not carried out and an NI RHI specific fraud prevention strategy, which took into account the differences between the GB and NI RHI Schemes, was never produced. In fact, as is discussed later in this Report, when Northern Ireland was added to a GB RHI Fraud Prevention Strategy in 2014 it erroneously said that the NI RHI scheme had the protection of tiering when it did not.
- 7.15 Dermot Nolan, Ofgem’s Chief Executive, accepted in his oral evidence to the Inquiry that an independent risk assessment of the NI RHI should have been done and that Ofgem did “get it

568 TRA-03655

569 WIT-103823 (E-Serve’s New Scheme Development department was then the department within Ofgem responsible for developing and operating the administration of new sustainability schemes such as RHI).

570 OFG-17383 to OFG-17389 at OFG-17384

571 DFE-79778

572 DFE-79795

573 OFG-81441; OFG-81452 to OFG-81477

574 OFG-81459

575 INQ-30157

wrong” in this regard. Had such an assessment taken place, he speculated that it would have covered lack of cost controls and issues about tiering.⁵⁷⁶ Mr Nolan accepted that this was “certainly a key failing.”⁵⁷⁷

- 7.16 In general, however, the Feasibility Study indicated that Ofgem could, and was in principle willing to, administer the NI RHI scheme on behalf of DETI, on the basis set out in the study. It was an important piece of work which further informed scheme development and planning within DETI and set out how Ofgem proposed to administer the scheme.

The appointment of Ofgem as administrator

- 7.17 To develop the systems for the NI RHI, Ofgem had proposed a budget of £386,000, with a contingency of 100% to cover uncertainty arising around final scheme policy, legal and IT work.⁵⁷⁸
- 7.18 On 18 April 2012 – after the Minister had cleared the submission of 16 March 2012 giving approval to proceed with the NI RHI scheme (discussed elsewhere) – Ms Hepper submitted a business case to Minister Foster for the appointment of Ofgem to administer the NI RHI scheme and to act as an external delivery organisation on behalf of DETI.⁵⁷⁹ The April 2012 submission referred to several advantages of using Ofgem for this role, including economies of scale, consistency of approach with GB, Ofgem’s sound track record and the adaptation of an existing system which would be quicker and carry less risk. It was proposed that Ofgem would be engaged via an Agency Services Agreement. The Minister recorded her approval on 24 April 2012.⁵⁸⁰ However, as appears later in this Report, the relationship between DETI and Ofgem was to prove far from straightforward and became subject to non legally binding ‘Arrangements’ rather than a contractual Agency Services Agreement.
- 7.19 There were ongoing differences of opinion in relation to the costs to be paid to Ofgem during the development phase. In August 2012 an internal Ofgem email recorded DETI as “quite frankly furious” to be told of a significant increase in costs. Minuted meetings between Ofgem and DETI representatives, which had apparently recorded assurances by Ofgem that the costs would not exceed £386,000, were attributed by Ofgem to “misunderstanding” on the part of their staff. Ofgem had calculated development costs to have risen to around £700,000, including a contingency sum.⁵⁸¹ These were later revised down to £430,000, which was accepted by DETI.
- 7.20 The Inquiry notes that in an effort to reduce costs, once again, the independent risk assessment that had not been carried out during the Feasibility Study was abandoned and replaced by a proposed joint GB-NI exercise. This, it was said, yielded a saving of £5,000.⁵⁸² Notwithstanding this, no evidence was presented to the Inquiry that even this joint risk assessment was ever carried out.
- 7.21 Paragraph 4.30 of the December 2011 Feasibility Study had recorded that Ofgem’s approach to NI:

576 TRA-16355

577 TRA-16357

578 Feasibility Study at DFE-79782 para 3.11 and DFE-79842 para 11.19

579 DFE-143898 to DFE-143920

580 DFE-143925 to DFE-143930

581 OFG-04738 to OFG-04739

582 OFG-04911 to OFG-04912

“...will benefit from the development work of GB RHI and provide a system that will ensure security of information, minimise fraud risks and human error and provide administrative efficiencies while providing the most cost-effective solution to meet the specific needs of the NI RHI.”⁵⁸³

7.22 In a January 2012 email exchange between E-Serve’s then managing director, Stuart Cook, and one of his senior managers, Bob Hull, Mr Hull went further and pointed out that:

“... a key value add ... is the benefit we provide in terms of fraud, error and ***gaming prevention and detection*** (the Inquiry’s emphasis). This is far greater value than any efficiency savings of us operating the scheme.”⁵⁸⁴

583 DFE-79790
584 OFG-03036

Findings

46. There was an early preference for Ofgem to be the NI RHI scheme administrator. The alternative of local administration was never seriously considered, even though in the responses to the public consultation some concerns were expressed about using a body based in GB, rather than in Northern Ireland, to carry out the work.
47. Ofgem failed to undertake the promised independent risk assessment which it had indicated on a number of occasions would be carried out; and did not establish a separate scheme risk register for Northern Ireland.
48. As discussed elsewhere, Ofgem failed to develop and implement the intended Fraud Prevention Strategy that addressed the risks specific to the NI RHI. Given that the GB and NI RHI schemes were not in fact the same, this failure by Ofgem left the NI RHI scheme potentially exposed to greater risk of abuse. Ofgem also failed to tell DETI that it had not carried out the intended independent risk assessment nor produced the intended fraud prevention strategy that addressed the risks specific to the NI RHI.

The November 2011 Ofgem legal review

- 7.23 On 11 October 2011, during the course of the Feasibility Study that it had commissioned by direct award contract in August, DETI sent Ofgem a draft of the proposed regulations grounding the NI RHI scheme.⁵⁸⁵
- 7.24 On 7 November 2011 the Ofgem legal team sent DETI a legal review of the draft NI regulations. The review consisted of 28 pages of detailed analysis, and Ofgem, in evidence to the Inquiry, placed considerable reliance on the document as evidencing the types of warnings Ofgem was giving to DETI prior to the NI RHI scheme commencing.
- 7.25 The review drew DETI’s attention to a number of issues which Ofgem had raised with DECC in relation to the GB RHI regulations but which, in Ofgem’s view, had not been addressed adequately or at all by DECC. Appendix 1 to the Ofgem legal review document contained a lengthy table of deficiencies that Ofgem raised in relation to the GB RHI regulations, replicated in the then draft Northern Ireland RHI regulations, and the appendix 2 comments were specific to NI matters.⁵⁸⁶ The former included some matters of particular significance under the heading “Potential perverse outcomes”, such as: “Some participants may install additional pipework and multiple smaller (and potentially less efficient) units in order to meet eligibility for higher tariff thresholds.” A suggested solution to such a potential outcome was to consider imposing a requirement that where separate heating systems serve the same end-heat-use purpose, they should be considered to be part of the same heating system.⁵⁸⁷ The document also included a reference to “gaming opportunities” with regard to the minimal restrictions imposed as to what should count as “eligible heat use”.⁵⁸⁸ Ofgem advised that it had concerns about other definitions, including “process” and “heating systems”.⁵⁸⁹ Under the general heading “Legal”, in the specific context of the proposed regulation 14, there was a reference to the absence of a clear definition of “heating system” from the draft NI regulations. Such a definition was seen (rightly, as it turned out) as the “key determinant” of whether multiple plants should be treated as a single installation and Ofgem warned that “DETI should add a defined term to ensure clarity. It is not acceptable for this to be clarified in the guidance.”⁵⁹⁰
- 7.26 Ofgem was seeking guidance from DETI as to whether it preferred to delay any changes to the draft NI regulations until DECC reviewed the GB regulations regarding these shared concerns or whether DETI wished to be proactive and address the issues raised, thereby establishing a more robust scheme from commencement.⁵⁹¹
- 7.27 In her oral evidence to the Inquiry Ms Hepper stated that these suggestions had been noted at the time but explained that their approach, as a matter of policy, was to follow DECC. In this instance, that appeared to be by way of introducing a scheme in Northern Ireland which reflected the frailties in the GB RHI regulations that had been identified by Ofgem and, if DECC took action in relation to those at a later stage, following suit at that point. In this regard, Ms Hepper noted that: “We didn’t have that in terms of the number... [of staff].”⁵⁹² She told

585 DFE-314352 to DFE-314407

586 DFE-314501 to DFE-314521; DFE-314522 to DFE-314526

587 DFE-314505 to DFE-314506

588 DFE-314506

589 DFE-314503

590 DFE-314514

591 DFE-314497 to DFE-314498

592 TRA-02660

the Inquiry that both Mr Harnack and Mr Hull of Ofgem knew that Northern Ireland would be “following the DECC track” in due course.⁵⁹³

7.28 Ms Hepper agreed that the issue of exploitation of the scheme by the use of multiple boilers had later become a major problem but observed that “at that stage DECC did not make that change, as you can see from the document, and we did have a discussion around that and it was highlighted in the guidance.”⁵⁹⁴ When she was reminded that Ofgem had expressed the clear view that it was not acceptable for it to be clarified in the guidance alone, Ms Hepper simply pointed out that it was in the DECC guidance.⁵⁹⁵

7.29 Mr Sterling told the Inquiry that the decision on the one hand to delay making the changes to the draft regulations recommended in the Ofgem legal review or, on the other, to adopt a proactive approach was the type of judgment that senior civil servants should make. The decision as to which approach to adopt in this instance was not discussed with him but should, as a minimum, have been escalated to Mr Thomson.⁵⁹⁶ For his part, Mr Thomson told the Inquiry that he could not recall the detail of the Ofgem legal review ever being so escalated.⁵⁹⁷

593 TRA-02649

594 TRA-02651

595 TRA-02651

596 TRA-06703 to TRA-06704

597 TRA-05722 to TRA-05723

Findings

- 49.** In November 2011 Ofgem provided DETI with a detailed legal review of the then draft NI RHI regulations. The NI RHI regulations would not come into force until November 2012. The legal review identified a range of potential weaknesses in the draft regulations, many of which were in keeping with potential weaknesses already present in the GB regulations which came into force in November 2011.
- 50.** Ofgem and DETI were therefore aware from the start of risks associated with certain unclear formulations in the regulations. However, as discussed later in this Report, Ofgem did not follow up with DETI, as it ought to have done, on the issues Ofgem had identified in November 2011.
- 51.** DETI itself, which received the November 2011 warnings from Ofgem, took little or no action to address the concerns. Ms Hepper agreed that there had been a series of discussions with Ofgem and that there was no written record of the significant decision, and the reasoning upon which it was based, as to what to do about the issues raised in the Ofgem legal review. The approach which DETI adopted was not to be proactive with regard to the warnings referred to by Ofgem in the legal review, including the issues of 'gaming' and 'useful heat', but simply to postpone consideration and wait to see what DECC would do.

