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## Chapter 8 – State Aid

- 8.1 The introduction of an RHI scheme to Northern Ireland, as it had in GB, raised questions of compliance with European State Aid rules. Article 107 of the Treaty on the Functioning of the European Union (TFEU) provides that any aid granted by a member state or through state resources which distorts or threatens to distort competition by favouring certain undertakings is incompatible with the internal market. Article 107(3) provides for certain exceptions, including aid to facilitate certain economic activities where such aid does not adversely affect trading conditions to an extent contrary to the common interest.<sup>598</sup>
- 8.2 EU Guidelines on State Aid for Environmental Protection issued in 2008 dealt with aid for renewable energy sources at 3.1.6. The relevant forms of aid were divided into Investment Aid at 3.1.6.1 and Operating Aid at 3.1.6.2.<sup>599</sup>
- 8.3 Stephen Moore was a deputy principal employed in the State Aid Unit of DETI, whose task it was to provide advice and assistance with regard to the potential application of EU State Aid rules.
- 8.4 Mr Moore told the Inquiry that most State Aid in Northern Ireland is Investment Aid, with some Operating Aid mostly applied in the energy sector.<sup>600</sup> Aid authorised in accordance with the Guidelines may not be combined with other State Aid or other forms of Community financing if such overlapping results in aid intensity higher than that laid down in the Guidelines.<sup>601</sup>
- 8.5 Mr Moore, who is not a lawyer, emphasised in oral evidence to the Inquiry that his role was to advise on the relevant rules and procedures rather than to provide legal advice. He would refer any legal issue to the Departmental Solicitor's Office, the Government solicitors in Northern Ireland. It was the task of the relevant branch or division within DETI to prepare the draft application for State Aid approval in compliance with the rules and he would then read the draft, adopting the approach of the Commission as he understood it, to ensure correct procedures had been correctly followed in accordance with the Guidelines.<sup>602</sup>
- 8.6 When he became aware of the economic appraisal work being undertaken by CEPA, in relation to a proposed means of incentivisation of renewable heat, instituted by DETI, Mr Moore emailed Mr Hutchinson on 17 February 2011 to remind him of the need to comply with the relevant State Aid rules.<sup>603</sup> He heard nothing more until the summer of 2011, when he became aware of DETI's consultation on the RHI. At that point he took the initiative to track down DECC's State Aid application for the GB RHI scheme and, on the back of this, he spoke to and emailed Mr Hutchinson on 4 August 2011 listing all the things Energy Division needed to do to comply with the rules.<sup>604</sup>
- 8.7 There was then a discussion in which Mr Moore pointed out that the GB RHI scheme had required notification to the Commission in accordance with Article 108(3) TFEU and that,

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598 LEG-15001 to LEG-15002

599 WIT-24661 to WIT-24662

600 TRA-03992

601 WIT-24662

602 TRA-03978 to TRA-03982

603 WIT-24602

604 WIT-24603

therefore, the NI RHI scheme should follow the same course.<sup>605</sup> The EU Commission must be given sufficient time to consider an application and Mr Moore was not optimistic about obtaining State Aid approval by the date then planned for the NI RHI scheme to go live, namely 1 April 2012, since he was aware that there was generally a queue of cases, and applications for Commission approval could take six to twelve months. He told the Inquiry that he repeatedly pressed Renewable Heat Branch for progress with the process of notifying the Commission.<sup>606</sup>

8.8 Mr Moore told the Inquiry that, at all relevant times, he believed he was dealing with an application for an NI RHI scheme similar to GB and he was never made aware of the Challenge Fund as a possible alternative means of incentivisation.<sup>607</sup>

8.9 The GB RHI scheme received approval from the Commission on 28 September 2011. Regarding a topic that would later emerge as very significant, it is interesting to note that the Commission document recording the decision to grant approval for the GB RHI scheme, after referring to how tiering would operate at paragraph 22, stated at paragraph 53 as follows:

“The Commission welcomes the two-tier approach for small and medium biomass installations which indeed are likely to reduce the perverse incentives to increase heat production beyond reasonable use in order to claim the RHI tariffs.”<sup>608</sup>

8.10 Mr Moore’s evidence was that he had been aware of the employment of tiered tariffs as a means of combating the perverse incentive to maximise returns and he took this to be at least a partial answer to that risk.<sup>609</sup>

8.11 Further time passed and Mr Moore again expressed his concern about delay by email, observing in November 2011 that a decision before 1 April 2012 looked “very unlikely.”<sup>610</sup> On 19 December 2011 Mr Moore received a draft application for State Aid approval from Mr Hutchinson. The draft did not include final figures for tariffs. Mr Moore was due to be out of the office over Christmas and indicated therefore that it was unlikely that the application would be made before January.<sup>611</sup> On the same day he received an email from Ms Hepper in the following terms:

“I want this submitted before Christmas – so, if you can’t look at it now, we will proceed and pick up any points you may have if we have to add further information re the tariffs. Peter and Joanne – please proceed.”<sup>612</sup>

8.12 In the event, the DETI notification was lodged on 20 December 2011 by Mr Moore with the then Westminster Department for Business, Innovation and Skills (BIS), through which all UK and devolved administration applications for State Aid had to be channelled and, after some helpful email exchanges, it was decided to proceed by way of a two-stage process, starting with pre-notification which was submitted by BIS on 21 December.<sup>613</sup>

605 TRA-04004 to TRA-04006

606 TRA-04006 to TRA-04007

607 TRA-03992 to TRA-03993

608 DFE-76682 to DFE-76683

609 TRA-04019 to TRA-04020

610 TRA-04023

611 TRA-04026

612 TRA-04027

613 TRA-04029

- 8.13 The annexes to the application included the CEPA Final Report from June 2011, which did not provide for tiering of tariffs in Northern Ireland, and draft NI RHI regulations, dated 4 October 2011, which did so provide at draft regulation 39(9).<sup>614</sup> The accompanying information sheet, completed by Mr Moore probably with the assistance of Mr Hutchinson, stated that: “The tariffs have been established ex-ante and there will be regular reviews. The first review is scheduled for 2014 with any changes or revisions implemented by 2015.”<sup>615</sup>
- 8.14 On 1 February 2012 it became clear that the Commission would seek some further information including, for example, details of the final tariff figures. On 20 February 2012 Mr Hutchinson sent Mr Moore the draft addendum to the State Aid application, which was designed to provide the necessary further information, together with the CEPA addendum report of February 2012. The notification paper prepared by Mr Hutchinson showed the relevant tariff for medium biomass boilers to be 5.9p/kWh and the CEPA report showed that this proposed tariff exceeded the cost of biomass fuel. Mr Moore accepted that he did not notice this fact, stating that he would not have considered it necessary to look for it and that, in any event, he did not have time; he was working on his own at the time.<sup>616</sup> Mr Moore also told the Inquiry:

“I certainly thought that energy division would’ve understood what was required, and therefore, from my risk assessment perspective, I thought this was a low-risk notification to the Commission and it didn’t contain any significant anomalies that I should be looking for.”<sup>617</sup>

It is fair to say that the EU officials provided with the material do not appear to have identified this problem either.

- 8.15 The final form of notification was submitted on 22 February 2012.<sup>618</sup> On 25 April 2012 the EU Commission forwarded three questions, which included seeking confirmation that the development of production costs as well as the tariffs and underlying costs would be the subject of scheduled reviews and that the UK authorities (i.e. the Northern Ireland authorities in this instance) would respect the annual reporting and monitoring provisions of the Guidelines. The questions were satisfactorily answered by Mr Moore and Mr Hutchinson. Some further questions were raised with regard to differences between the GB and NI schemes which were referred to Mr Hutchinson.
- 8.16 Significantly, the question<sup>619</sup> relating to the absence of tiering of tariffs in respect of medium and small biomass installations in Northern Ireland was answered by stating: “In developing tariffs DETI also considered this issue however in all cases, the subsidy rates were found to be lower than the incremental fuel expense”, thereby replicating the error based in the CEPA February 2012 addendum.<sup>620</sup> Mr Moore read these replies but did not return to the CEPA addendum for confirmation.<sup>621</sup> He told the Inquiry:

614 TRA-04037

615 TRA-04038 to TRA-04039

616 TRA-04057 to TRA-04059

617 TRA-04058

618 TRA-04063

619 DFE-78086

620 TRA-04076

621 TRA-04077

“Whenever this all came to a head and was pointed out to me by Michael Woods in Internal Audit [in 2016], it was fairly obvious to me, and immediately I was thinking to myself, ‘Well how on earth did I miss this?’ I think time is a factor in it.”<sup>622</sup>

- 8.17 A positive decision recording approval of the NI RHI scheme was received from the Commission on 12 June 2012.<sup>623</sup> The Commission recognised that the primary objective was environmental protection with a view to increasing the uptake of renewable heat in Northern Ireland to 10% by 2020 and also to support the displacement of oil as the primary heating fuel. Paragraph 24 of the Commission decision noted that the tariffs had been set based on economic advice from external consultants.<sup>624</sup> Paragraph 43 stated that the methodology followed for setting the tariffs had been the same as that used for the GB scheme, apart from the use of uniform discount rates to value costs in future years.<sup>625</sup> Tables annexed to the approval showed the tariff for medium commercial biomass installations to be 5.9p/kWh, which was higher than the cost of the fuel which was stated to be 4.39p/kWh. That tariff was lower than the equivalent GB tariff but was not tiered.<sup>626</sup> Paragraph 34 of the approval noted that, in order not to provide perverse incentives to waste heat, each reference installation was calibrated to have a specific load factor with reference to which the tariff was calculated, providing as an example a load factor of 15% – meaning that the installation would be used at full capacity for 15% of the time. If this meant that the Commission believed that the use of an assumed load factor when calculating the tariff in some way guarded against the perverse incentive it was in error, but it does not appear that such an error was ever corrected by DETI.<sup>627</sup>
- 8.18 Paragraph 39 of the approval recorded that the UK authorities intended to carry out early reviews where they became aware of significant changes in production costs to ensure against overcompensation.<sup>628</sup> At paragraph 62 the Commission recorded the need for the tariff calculation to avoid “systematic overcompensation” and at paragraph 63 noted that a discount rate of 12% applied which coincided with the rate adopted in GB and lay at the lower end of the range 8% to 22% stated to be necessary by the detailed report from the independent consultant.<sup>629</sup> Paragraph 67 recorded that, with respect to the absence of overcompensation in time, the UK authorities had confirmed that production costs would be monitored over time through scheduled reviews.
- 8.19 At paragraph 70 the Commission made an express determination that the scheme was approved “in the light of the above mentioned considerations, **including the commitment of the UK authorities to adapt the notified measure in time in order to avoid overcompensation**” (the Inquiry’s emphasis); and at paragraph 79 confirmed the conclusion of the Commission that the scheme was compatible with the internal market.<sup>630</sup>

622 TRA-04062

623 WIT-24623 to WIT-24642

624 WIT-24630

625 WIT-24631

626 WIT-24629

627 WIT-24629

628 WIT-24630

629 WIT-24633 to WIT-24634

630 WIT-24634

## Findings

- 52. Mr Moore appears to have provided unstinting support to the officials in Energy Division, despite being repeatedly provided with very late information and then being expected to provide an immediate response.**
- 53. The State Aid approval was very clearly made reliant on the need for regular review and the obligation to avoid overcompensation. In fact, no reviews of the scheme or the tariffs were carried out by the Department until 2018. Although a tiering mechanism had been introduced in 2015, that was simply as an emergency measure rather than as a consequence of a carefully conducted and analysed review.**

