From:	McCormick, Andrew (DETI)
To:	Mills, John (DETI)
Cc:	Stewart, Chris (DETI); Wightman, Stuart; Rooney, Eugene; Cooper, Trevor; Hill, Janice
Subject:	FW: Submission - Future of RHI
Date:	23 December 2015 15:13:51
Attachments:	Submission - Future of RHI.docx

Many thanks. Please see my suggestions.

From: Mills, John (DETI)
Sent: 23 December 2015 14:00
To: Stewart, Chris (DETI); McCormick, Andrew (DETI)
Cc: Wightman, Stuart; Rooney, Eugene; Cooper, Trevor
Subject: Submission - Future of RHI

As discussed, I attach draft submission inviting Minister to agree to closure of RHI schemes. 1) I am not sure what to say about the lack of retrospective approval, 2) we are working on how to effect closure (see below) and 3) not sure if we should get Minister to write to FM making case for different HMT outcome – however forlorn .

Have pondered Andrew's question on comparison with NIRO closure. It may be possible to speed things up by announcing closure concurrently with the legislative process. Thus, let's say the legislation comes into effect at the start of March, notice of closure could be given for the next day instead of giving 6/4 weeks notice as long as the Minister had made an announcement 4/6 weeks prior to this giving notice of closure. The legislation might be able to say that notice can be given before or after the legislation comes into effect.

This is similar to what the SofS did in GB on NIRO. In effect she said, "As of today (18 June 2015) I am warning you that by March 2016 you won't be able to get ROCs unless you have planning, land and connection sorted out." The legislation will say, "as of today (or some future point) you have to have land, planning, connections in place to get ROCs." That's why it's not retrospective. If the legislation doesn't get through, DECC won't be able to "turn the tap off" regardless of what the SofS has said and their £2bn "overspend" will continue to grow.

The risks for us of this course (if it's possible) are similar. We could announce, provoke a spike in applications to meet the deadline and then fail to deliver our own deadline.

From:	**John Mills**	**Tel No:** 29425
Date:	**23 December 2015**	
To:	**1. Timothy Cairns** **2. Jonathan Bell MLA**	

Copy Distribution List below

FUTURE OF RENEWABLE HEAT INCENTIVE

Issue:	Future of Northern Ireland Renewable Heat Incentive (RHI)
Timing:	A decision on the future of the RHI is needed immediately quickly to enable ~~any~~ the necessary legislative changes to made ~~early in 2016~~as soon as possible in order to minimise the overspend that has arisen with the existing scheme.
Executive Committee Referral:	A change in target may [DN need to be clear whether or not] require Executive approval. [DN possibly controversial given scale of irregular expenditure]
PFG Implications:	The PSA targets for renewable heat are 4% by 2015 and 10% by 2020.
Presentational Issues:	~~Internal~~Likely to attract criticism given the scale of the unapproved expenditure
FOI Implications:	Not discloseable on grounds of policy development.
Financial Implications:	~~Funding for the scheme payments is via Annually Managed Expenditure, (AME).~~Treasury has indicated that the cost overrun may need to be covered from the Executive's Resource DEL, which if confirmed would imply an opportunity to cost to DETI or other NI Block services of [£23m a year for 20 years – DN correct figures please]
Legislation Implications:	Any changes to the scheme require, at least, affirmative resolution regulations.

Statutory Equality Obligations:	Equality screening shows that the proposed Regulations do not have a significant equality impact.
Recommendation:	That you: • agree to close~~/suspend~~ both RHI schemes as soon as possible; • agree to procure additional audit checks for the Non Domestic RHI scheme.

BACKGROUND

1. The Non-domestic RHI scheme was introduced in November 2012. The Domestic RHI scheme in December 2014. Both schemes provide payments for people to move from conventional heating (mainly oil) to sustainable heating such as wood pellets (biomass). In light of unprecedented applications over the last 2 months for the Non Domestic Scheme, ~~and~~ the outcome of the Government's Spending Review, and consideration by DFP and HMT of developments in respect of the non-domestic scheme here, an urgent decision is now needed on the future of the NI RHI schemes.

SCHEME PERFORMANCE

2. Successful domestic RHI applicants receive an upfront payment of up to £3,500 (depending on the technology) along with 7 annual tariff payments based on the heat requirements of the property. Annual payments are typically around £1,200 but are capped at a maximum of £2,500. Uptake of the Domestic RHI scheme has been steady with over 700 applications received in the 12 months since it was introduced.

3. The Non Domestic RHI scheme on the other hand involves 20 years of annual tariff payments based on the metered heat usage of the business. Tariffs are dependent on the type and size of technology. To date, average annual payments of been around £24,000. The Non Domestic scheme therefore involves much larger and longer financial commitments than the domestic scheme.

4. After a slow start during the first two years, non-domestic scheme uptake increased steadily during 2015. During the Autumn of 2015 there was a surge in applications. This increase relates to one particular technology – biomass and has been attributed to one particular industry's wholesale uptake of the scheme. This is the poultry industry's use of RHI for chicken sheds. Uptake of the non domestic scheme and the forecast expenditure is summarised in the table below.

Period	Application Numbers	Annual Cost	20 Year Cost
Nov 2012 – March 2015 (Previous Commitments)	**522**	**£12.3m**	**£246m**
April 2015	85	£1.1m	£22m
May 2015	66	£1.4m	£28m
June 2015	49	£1.3m	£26m
July 2015	42	£0.9m	£18m
August 2015	55	£1.1m	£22m
September 2015	90	£2.14m	£42.8m
October 2015 (up to 28/10/15)	441	£9.8m	£196m
Total for Retrospective Period (1/4/15 – 28/10/15)	**828**	**£17.74m**	**£355m**
November 2015 (29/10/15 – 29/11/15)	452	£9.95m	£199m
December 2015 – March 2016 (forecast)	80	£1.92m	£38.4m
Total for Prospective Period (29/10/15 – 31/3/16)	**532**	**£11.9m**	**£238m**

Total Forecast Commitments to 31 March 2016	**1882**	**£41.94m**	**£839m**

5. The sustained increase in applications during March and April was the catalyst for the legislative changes you recently took through the Assembly to, inter-alia, introduce a tiered tariff [reducing after 1,314 hours] and an annual cap [at 400,000 KWh] on RHI payments for biomass. However, in the run up to these legislative changes, scheme uptake has rocketed with a further 900 applications received in 6 weeks. An increase in applications had been forecast as businesses try to beat the deadline, but not at the numbers we received.

6. The increase in applications means that over 167MW of renewable heating capacity has now been installed under the non domestic scheme. This equates to between 6.7% - 8.3% of total installed capacity under the GB non domestic scheme. It is estimated that over 6% of NI's total heating needs are now provided through renewable technologies. The PfG target of 4% renewable heat by 2015 has been exceeded and we're well on our way to achieving the Executive's 2020 target of 10%. However, this success comes at a price. Total expenditure for both RHI schemes in 2015/16 is now forecast to exceed £30m. Even if no new applications are received in 2016/17 (i.e. both schemes are suspended / closed on 31/3/16), forecast RHI expenditure in 2016/17 is expected to be around £42m.

DFP APPROVAL

~~6.~~7. When the non-domestic scheme was established in 2012, DETI sought and obtained approval of a business case from DFP and one of the conditions was for re-approval in March 2015. Unfortunately the need for this approval was overlooked. DETI had no choice but to keep making the payments, because ~~T~~the RHI scheme is set out in statutory Regulations, and hence ~~. T~~there are no grounds for DETI to cease making payments to properly made applications. despite the lack of DFP approval).~~When the non-domestic scheme was established in 2012 DETI sought approval of a business case for the scheme from DFP and one of the conditions was for re-approval in March 2015. Unfortunately the need for this approval was overlooked (DETI had no choice but to keep making the payments it was legally obliged to make despite the lack of DFP approval).~~

8. DFP approval was subsequently sought for retrospective and future operation. Prospective approval has now been received from DFP for scheme expenditure from 1 October 2015 through to 31 March 2016 on certain conditions which include, tariff changes (done), a review and a further approval from March 2016. Retrospective approval from 1 April 2015 to 30 September 2015 has, as of 21 December, been declined, because we cannot meet the test that had we sought approval at the time it was required, DFP would have been able to approve. The underlying problem is that DECC had introduced contingent cost controls in their parallel scheme in 2013, and had drawn this to DETI's attention in Ministerial correspondence, but DETI had not acted on this, leaving us vulnerable to the acceleration of expenditure which has now arisen.~~. The reason given is the lack of opportunity for DFP to assess the situation at an early stage.~~

~~7.~~

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AFFORDABILITY

~~8.~~9. The affordability of RHI going forward obviously depends on the budget available. The RHI schemes (non-domestic and domestic) are paid out of AME. To quote the HMT Autumn Statement of 2015, “the UK government provides funding for certain programmes which are devolved....if they are not only demand-led but also may be volatile in a way that could not adequately be controlled by the devolved administration[1]”. It goes on to give assurance that devolved administrations do not have to find off setting savings for increases but warns that they may have to fund schemes that are more generous than elsewhere in the UK.

~~9.~~10. However, when the scheme was first introduced in 2012, HMT confirmed that RHI spending ~~is~~ would not be~~ing~~ treated as standard AME, where the Exchequer takes on all risks. Instead, there is a risk-sharing arrangement whereby, should RHI spending in one year exceed the allocated budget, NI would need to repay this in future years. This could be achieved through scheme changes. However, the rules provided that a small proportion of any required future savings (likely to be of the order of 5%) would have to be funded directed by NI through DEL.

~~10.~~11. Also, unlike traditional AME, the initial 4 year (2011/12-2014/15) NI allocation of £25m was based on a Barnett formula of c.3% of the DECC budget (£838m). HMT confirmed that any 20 year commitments entered into during this period would be honoured. This arrangement was rolled forward in 2015/6 though the AME 2015/16 budget has since been raised to £23m in light of increased demand.

~~11.~~12. If RHI funding was “pure” AME there would be no impact on NI DEL (of course, we would still need to take action due to the sharp increase in costs). If the Barnett formula + 5% penalties approach was carried forward the effect on NI DEL would be relatively small – generally less than £1m p.a. over the 2016/17–20/21 period (this assumes scheme closure in March 2016).

CHANGE IN HMT POLICY

~~12.~~13. However, the effect of the Chancellor’s Autumn Statement was to reduce the NI RHI budget and, on 21 December, DFP advised that HMT’s likely position ~~is~~ will be that NI will have to cover the full costs (not 5%) of any overspends. This creates significant budgetary pressures for the next 20 years with additional annual costs of up to £23m to meet.

~~13.~~14. Discussions between DFP and HMT are ongoing but we must proceed on the basis that ~~“~~the major overspend that has now arisen~~s”~~ will not be covered by HMT.

~~**DFP APPROVAL**~~

[1] The NI Renewable Heat Incentive is listed as a NI Executive AME Programme at Table E3 of the HMT Statement of Funding Policy – funding the Scottish Parliament, National Assembly for Wales and NI Assembly – November 2015.

~~14.~~15. ~~The RHI scheme is set out in statutory Regulations. There are no grounds for DETI to cease making payments to properly made applications. When the non-domestic scheme was established in 2012 DETI sought approval of a business case for the scheme from DFP and one of the conditions was for re-approval in March 2015. Unfortunately the need for this approval was overlooked (DETI had no choice but to keep making the payments it was legally obliged to make despite the lack of DFP approval).~~

~~15.~~16. ~~DFP approval was subsequently sought for retrospective and future operation. Prospective approval has now been received from DFP for scheme expenditure from 1 October 2015 through to 31 March 2016 on certain conditions which include, tariff changes (done), a review and a further approval from March 2016. Retrospective approval from 1 April 2015 to 30 September 2015 has, as of 21 December, been declined. The reason given is the lack of opportunity for DFP to assess the situation at an early stage.~~

OPTIONS

~~16.~~17. The combination of lack of HMT funding and DFP approval together with DETI's ongoing, legal obligation to keep making RHI payments means there is very little scope for action other than to suspend~~/close~~ the scheme as quickly as possible. However, the options are:

- **Do nothing (i.e. keep the RHI scheme open).** This would help reach the Executive target of 10% renewable heat by 2020, help reduce green house gas emissions, contribute to the UK's renewables obligations and support the local renewables industry (at a time when other support, in the form of NIRO, is being withdrawn). It is assumed that anything above the HMT proposals would have to be funded from DEL. The shortfall from 2016/17 - 2020/21 is estimated to be around £165m (roughly £30m pa). However, experience has taught us that the scheme is extremely difficult to predict and there would be a risk that actual expenditure could be higher. Finally, we simply do not have funding for existing commitments over the HMT figures, let alone any extra. Following this course would require Executive agreement – which is unlikely given existing overspend and the DEL impact.

- **Continue domestic scheme only**. The funding problems have arisen in respect of the non-domestic RHI, principally as a result of the increase in installation under one tariff (biomass) for one industry (poultry). The domestic scheme is much more evenly distributed in terms of technologies and has been steadier in terms of growth. It could be asked why the domestic scheme should suffer as a result of events on the non-domestic side. Separating out the two schemes to close the non-domestic and leave open the domestic might cost a total of £105m over the five years 2016/17-2020/21 (something like £20m pa). Keeping open the domestic scheme may help mitigate an adverse industry reaction. However, HMT do not distinguish between the two schemes so keeping open the domestic scheme adds costs to what is already an overspend in terms of current HMT requirements. In addition, there is a risk that the domestic scheme would prove unpredictable. If non-domestic markets were no longer available, supplier efforts could be targeted on the domestic market resulting in a spike in applications.

- **Close~~/suspend~~ both schemes as soon as possible**. Given the funding situation arising from HMT's proposals (and DFP conditions for approval of the non-domestic scheme to March 2016) there seems little choice but to bring potential increases in scheme costs to as swift an end as possible. If both schemes are closed by April 2016 the costs might be around £75m over the five years (around £15m pa [DN does this mean immediate closure reduces the costs from £23m a year to £15m a year? If not is some further explanation necessary?]). However, opposition from the industry (including legal action) can be anticipated. There is also the risk of increasing costs in the short term by setting a deadline which suppliers then attempt to achieve. The latter risk could be avoided by giving no notice of scheme closure. On the other hand such action would increase risk of legal challenge – particularly from those who have invested in installation only to find they cannot get the anticipated RHI payments (RHI installations have shorter lead times than NIRO projects – typically 6 weeks). We ~~will~~ are seeking legal advice. Inevitably there would be some public warning, even if there was no notice, as the policy and legislation would have to be progressed through the Committee and Assembly (and possibly the Executive prior to that).

CONCLUSION

16. To minimise further "overspending" and to meet the conditions of DFP's approval, we now have no choice but to ~~suspend/~~close both the non-domestic and domestic schemes as soon as possible. This may seem drastic but, as the RHI payments are for 20 years, the funding risk is very serious indeed. Separate advice on handling will be submitted once you agree the policy approach. ~~Consideration will also be given to writing to the Finance Minister to make the case for RHI with HMT.~~

NEED FOR ADDITIONAL AUDITING OF NON DOMESTIC RHI SCHEME

17. There have been recent anecdotal claims that applicants are abusing the NI Non Domestic RHI Scheme. This issue was recently raised at the DETI Audit Committee. Although we currently have no evidence to support these claims, it is recommended that additional audits are completed for the NI Non Domestic RHI scheme.

18. The Non Domestic RHI scheme administered on DETI's behalf by Ofgem (the GB gas and electricity regulator) which~~e~~ also administers the GB domestic and non domestic schemes. Ofgem's administration costs for the NI scheme are based on 3% of the GB scheme costs. Ofgem complete an annual programme of audits for the GB and NI schemes which includes desk based analysis and on-site checks. In 2015/16, Ofgem will be competing 200 detailed site audits for the GB Scheme. This translates into 6 site audits for the NI scheme.

19. In light of the increased number of applicants and recent claims of scheme abuse, we are arranging for additional audits to be completed by Ofgem this year. However each audit will cost around £1,000. This is because Ofg~~h~~em have to procure an external assurance provider to travel to NI to conduct the audits. In the longer term, it would be more cost effective to procure a separate local assurance provider. A Business Case will therefore be prepared for an additional audit programme from 2016/17 to complement Ofgem's current systems of assurance and control. This might cost in the region of £100K.

Recommendation

20. That you:

- Agree to close/suspend both RHI schemes as soon as possible; and
- Agree to procure additional audit checks for the Non Domestic RHI scheme.

JOHN MILLS
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cc: Andrew McCormick
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