DFE-152977

From:	McCormick, Andrew (DETI)
To:	Mills, John (DETI)
Cc:	Stewart, Chris (DETI); Wightman, Stuart; Hughes, Seamus; McIlwrath, Linda; Hill, Janice; Cooper, Trevor; Rooney, Eugene; Brankin, Bernie
Subject:	RE: Future of RHI and NIRO
Date:	31 December 2015 13:20:58
Attachments:	Submission - Future of RHI.DOCX

Would the changes in the attached work?

Many thanks.

From: Mills, John (DETI)
Sent: 31 December 2015 12:05
To: McCormick, Andrew (DETI)
Cc: Stewart, Chris (DETI); Wightman, Stuart; Hughes, Seamus; McIlwrath, Linda; Hill, Janice; Cooper, Trevor; Rooney, Eugene; Brankin, Bernie
Subject: RE: Future of RHI and NIRO

Andrew,

Well spotted, should be 29 October – simply an error in the sub.

Suspension v. Closure. Yes, left that in. I recommend keeping open the option of suspension at this point because: 1) we will stop the scheme to new applications asap (if the Minister agrees) regardless of whether that is through closure or suspension; 2) as either will require notice, there will be little or no difference in timescale; 3) if closure can be done more quickly, we will do that; 4) we should not underestimate the opposition to closure or suspension but the latter will be more acceptable and suspension answers the "what happens in the future" questions that we face on the NIRO (albeit there would have to be several changes to the current scheme anyway) ; 5) although it may seem out of touch with present reality, had HMT not cut the UK RHI budget we would have been back in the black after 3 years. Things could change as the UK gets closer to failing its EU renewable obligations and would we want rule out even the prospect of future Westminster funding?

I think suspension is preferable but not if it takes longer. Happy to refer only to closure if you prefer

From: McCormick, Andrew (DETI)
Sent: 31 December 2015 09:33
To: Mills, John (DETI)
Cc: Stewart, Chris (DETI); Wightman, Stuart; Hughes, Seamus; McIlwrath, Linda; Hill, Janice; Cooper, Trevor; Rooney, Eugene; Brankin, Bernie
Subject: RE: Future of RHI and NIRO

Many thanks, John.

Two queries:

- If DFP approved expenditure from 1 October 2015 (paragraph 8) why does the table at paragraph make the distinction at 28 October (we need to be clear on the amount of expenditure which is irregular, and clearly the commitments in October affect this point in a very significant way). Please confirm this with Finance Directorate, as it will be important to have consistency with the treatment of this expenditure in budgets and accounts;
- In a couple of places there is still reference to possible suspension – if that is intended, the case would need to be made – simpler I would have thought just to drop the word.

Happy to discuss.

From: Mills, John (DETI)
Sent: 30 December 2015 17:29
To: McCormick, Andrew (DETI)
Cc: Stewart, Chris (DETI); Wightman, Stuart; Hughes, Seamus; McIlwrath, Linda; Hill, Janice
Subject: Future of RHI and NIRO

Andrew,

Not sure if you want to see RHI sub again. The attached is largely a tidied up version reflecting the amendments you made before Christmas. I'll issue tomorrow unless you instruct otherwise. Hoping to get draft sub on NIRO also before new year.

From: **John Mills** **Tel No:** 29425

Date: **30 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 is needed immediately to pursue the necessary legislative changes to minimise overspending on the existing scheme.
Executive Committee Referral:	Yes. Paragraph 2.4 of the Ministerial Code requires referral of matters that have implications for the PfG (10% target not being reached if scheme closed) or are "significant or controversial" which this would be. It might also be considered cross cutting.
PFG Implications:	The PfG targets for renewable heat are 4% by 2015 and 10% by 2020.
Presentational Issues:	Likely to attract criticism given the scale of the unapproved expenditure
FOI Implications:	Not discloseable on grounds of policy development.
Financial Implications:	Treasury has indicated that the cost overrun may need to be covered from the Executive's Resource DEL which, if confirmed, would imply a substantial opportunity cost to DETI or other NI Block services.
Legislation Implications:	Any changes to the scheme require, at least, affirmative resolution regulations.
Statutory Equality Obligations:	Equality screening suggests the proposed Regulations do not have a significant impact.
Recommendation:	That you: • agree to close (or~~/~~ 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, 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 increased steadily (c.700 applications since the scheme 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 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 an estimate of indicative 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

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 the RHI scheme is set out in statutory Regulations and there are no grounds for DETI to cease making payments to properly made applications.

8. DFP approval was subsequently sought for retrospective and future operation. Prospective approval has now been received from DFP for scheme expenditure from ~~1~~ 29 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.

AFFORDABILITY

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

[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.

warns that they may have to fund schemes that are more generous than elsewhere in the UK.

10. However, when the scheme was first introduced in 2012, HMT confirmed that RHI spending would not be 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.

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.

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

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 will be that NI will have to cover the full costs (not 5%) of any overspends. This creates significant budgetary pressures for the next 5 years with additional average[2] annual costs of around £15m even if there are no new applications after the end of this financial year.

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

OPTIONS

15. 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 close/suspend 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 greenhouse 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

[2] Costs in the first year (i.e. 2016/17) would be higher and gradually diminish as time went on. This is because, if the scheme was closed to new applications, its costs would remain static while the allowed HMT budget would rise thus reducing the estimated NI scheme overspend from around £23m in 2016/17 to around £7m by 2020/21).

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 existing non-domestic overspend. 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 (or 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 to new applications by April 2016 the costs might be around £75m over the five years (around £15m p.a.). 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). It may be possible to keep some options open by suspending rather than finally closing the schemes, though we would not recommend doing so if that would lead to any delay. We are seeking legal advice on the issues around closure and will advise further on this and the suspension option as soon as possible. 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 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 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.

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 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 Ofgem 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 (or ~~/~~suspend) both RHI schemes as soon as possible; and
- Agree to procure additional audit checks for the Non Domestic RHI scheme.

JOHN MILLS
Energy Division
Ext. 29215

cc: Andrew McCormick
Chris Stewart
Eugene Rooney
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Trevor Cooper
Rob Robson
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