From: Rooney, Eugene
To: Cooper, Trevor; Woods, Michael (DETI)
Subject: FW: RHI
Date: 01 February 2016 09:04:59
Attachments: RHI McCormick to HOCS(2).DOCX

Trevor, Michael

We discussed the Audit work on Friday. You will note from this draft reply that Energy may already be in touch with OFGEM on the whistleblower issue para 13.

-----Original Message-----
From: Stewart, Chris (DETI)
Sent: 31 January 2016 14:27
To: McCormick, Andrew (DETI)
Cc: Mills, John (DETI); Wightman, Stuart; Rooney, Eugene
Subject: FW: RHI

-----Original Message-----
From: Chris Stewart [mailto:[redacted]
Sent: 31 January 2016 14:23
To: Stewart, Chris (DETI)
Subject: RHI

Andrew

Revised draft attached. There are one or two DNs.

C

From: Andrew McCormick
Permanent Secretary

Tel: 29441

Email: andrew.mccormick@detini.gov.uk
janice.hill@detini.gov.uk

Date: 28 January 2016

Our ref: PS DETI [xxx/16]

To: HOCS
David Sterling DFP

Cc Chris Stewart
Eugene Rooney
John Mills

RENEWABLE HEAT INCENTIVE (RHI)

1. In my note of 28 January I indicated that I would provide you with a fuller explanation and timeline of the genesis and evolution of the current RHI difficulty and DETI's response. I am also responding to the points raised in David Sterling's letter to me of 29 January.

2. In doing so I wish to address any incorrect impression given to you that both the problem and the solution were 'fully formed' and recognised in July 2015, and that DETI has failed to take the necessary action since then. In fact, whilst the problem began to emerge in early summer, the full extent of the likely overspend and the need for suspension did not materialise until December 2015. During that period DETI's actions developed in response to the evolving problem, in line with Ministerial decisions. The timeline of actions is set out at the Annex.

Background

3. The RHI schemes were introduced to meet an Executive target (PFG) of having 4% of Northern Ireland's heating needs met from renewable sources by 2015, and a further target in the Strategic Energy Framework of achieving 10% renewable heat consumption by 2020. This is NI's contribution to a binding UK target on renewable energy. The schemes have been given a high priority by Ministers Bell and Foster.

4. From the outset, RHI schemes have been demand-led, and funded as Annually Managed Expenditure (AME). This recognised that demand can be volatile, and difficult to forecast. However, the AME funding arrangements were qualified by an expectation that demand would be managed year on year to remain within an overall cost envelope. In addition, a

penalty of 5% of any expenditure over 'budget' in any given year would be applied to Resource DEL (RDEL). The implications of this for the scheme design are covered below.

Contributing factors

5. There were four factors that contributed to the exponential growth of projected spend, and the difficulty in bringing it under control:

i. **The inherent vulnerability of the legislation** – The 'qualified AME' funding arrangements pointed to the need for demand management arrangements within the RHI legislation. However, the legislation was enacted without including any powers to close or suspend the RHI schemes, and with inadequate control mechanisms. It compares particularly unfavourably to GB legislation in this regard. A further opportunity was missed in [2013] when additional controls were introduced to GB legislation. A decision was taken not to replicate those controls in NI. [DN need to say why]. This meant that, when difficulties emerged, DETI's response was slowed by the need for legislative change.

ii. **Exploitation of the vulnerability.** The existence of a vertically integrated poultry industry in NI, dominated by one large firm, meant that demand could be (and was) very rapidly stimulated, and was accelerated further when it became known that scheme controls were to be introduced. In the space of 6 weeks in Autumn 2015, the number of installations doubled from the 900 that had been received in the previous 3 years. The underlying risk of exploitation was disproportionately large in NI. Whilst our RHI budget is set as a Barnett proportion of the GB budget, NI's share of the UK poultry industry is much larger, at some [x] %. Therefore, the response by the poultry industry had a disproportionate effect in NI - at peak demand some [10%] of UK RHI applications were originating in NI.

iii. **Prolonged uncertainty over the available budget cover**. From July, discussions took place with DFP and Treasury to seek additional budget cover, while controls were being put in place. It took until December 2015 for a definitive decision to be made by Treasury that the budget would continue be limited to a Barnett share of the DECC budget. Had this been known before the November Spending Review outcome, DETI may have opted to move straight to suspension, rather than to introduce tariff controls. That would, of course, have been a decision for the Minister.

iv. **Change in Treasury position**. At inception of the RHI schemes, the rule promulgated by Treasury was that spend above allocation would attract a 5% Resource RDEL penalty. It was not until 22 December that Treasury conveyed the decision that all overspending must be met from RDEL, <u>a decision that transformed a relatively manageable problem into a criticality.</u> This decision meant that, de facto, RHI ceased to be an AME-funded scheme. Had that decision been made at the outset (or if the risk of such a change had become apparent earlier), the approach to the design of RHI would have been very different.

6. The above factors were compounded by DETI's failure to seek re-approval for the scheme as required from 1 April 2015. This meant that an important opportunity to review the scheme and address its vulnerabilities was missed. However, whilst this might have reduced the extent of the overspend to some degree (if legislative controls had been introduced earlier), it is highly improbable that it would have eliminated the problem entirely. Any legislative change required a period of consultation, and subsequent experience demonstrated all too clearly the propensity for an exponential spike in demand by a well-informed poultry industry in response to an impending change.

Timeline

7. Concern about rising expenditure became acute in July 2015. Throughout the period from July to December, DETI's actions were informed by a clear Ministerial steer to ensure that our response would be proportionate, and would not unduly prejudice the benefits of the scheme in terms of the renewable heat target, or the economic benefits to scheme applicants and installation firms. This was against a background of the scheme having *underperformed* prior to 2014, necessitating an advertising campaign to stimulate demand. The Minister [and his adviser] were wary of taking over-robust or precipitate action. We might all take the view now that this was an underestimation of the financial risk. Nevertheless, it was the clear and consistently expressed view of the Minister and his advisor.

8. The course of action agreed with the Special Adviser and recommended to the Minister on 8 July 2015 (item 1 in the timeline in the Annex) was twofold:

   - to legislate to introduce tariff controls as soon as possible; and
   - to review the underpinning legislation and bring forward proposals for further controls in due course.

9. Following further discussion with the Special Adviser in August (timeline item 2), during which the potential to moderate the tariff reduction was explored, the Minister agreed the recommended way forward on 3 September 2015 (timeline item 3). The timescale for securing Ministerial agreement meant that the target date for introducing the controls slipped from 1 October 2016 to 1 November 2016. DFP, whilst being rightly critical of DETI's failure to seek re-approval, did not demur from this approach, and agreed to the revised tariff approach on 29 October (timeline item 4). <u>At that point, neither DETI nor DFP regarded complete closure or suspension of the scheme as merited.</u>

10. The subsequent passage of the legislation through the ETI Committee and the Assembly was delayed as a consequence of Ministerial resignations in the autumn, and the Speaker's ruling on the conduct of Ministerial business by another Minister. This meant that the legislation was not passed until 17 November, coming into force the next day (timeline item 5). <u>Unfortunately, the 10 week period between the announcement of changes on 8 September, and their coming into effect on 17 November left ample opportunity for a spike in demand. This was beyond DETI's control.</u>

11. The situation was monitored closely, and demand continued to grow; well beyond even the highest estimates from earlier in the year. On 31 December, in recognition of the serious financial risk, further advice was offered to the Minister, recommending legislation to provide for the suspension of both RHI schemes (timeline item 6). This was agreed at a meeting with the Minister on 11 January (timeline items 7 and 8).

12. A draft consultation paper and Executive paper were sent to the Minister on 19 January (timeline item 9). The Minister was on the point of approving these, but is reviewing the way forward in light of the concerns raised by the First Minister, deputy First Minister and Finance Minister on the need to achieve suspension as soon as possible. The Minister has now approved the papers on the basis that Executive approval will be secured by urgent procedure, and that there will not be a public consultation. (I should point out that the Departmental Solicitor has advised that this carries a significant risk of legal challenge.)

Whistleblowing allegation of fraud

13. The unprecedented increase in demand has clearly increased the risk of fraud. As I indicated in my note of 28 January, DETI has responded to this by initiating procurement of additional auditing and checks. Your minute of 27 January enclosed correspondence to the First Minister, alleging abuse of the scheme. [DN Stuart to confirm please I have drawn this to the attention of OFGEM (the managing authority) and asked for an urgent investigation. I have also asked DETI's Head of Internal Audit to investigate the matter.]

Letter from David Sterling

14. Turning to the points in David Sterling's letter, he asked for an explanation for the non-renewal of DFP approval. The explanation lies in a combination of staff changes and an administrative oversight. Subsequent to the requirement for re-approval being put in place, there were changes in DETI personnel at every level from Grade 7 to Permanent Secretary, and the corporate memory lapsed. Nevertheless, administrative arrangements ought to have been in place to trigger an application for re-approval at the appropriate time. They were not; and the matter came to light only when budget confirmation was ought. I have asked DETI's Head of Internal Audit to consider this particular matter as part of his investigation.

15. As indicated above (paragraph 6), an application for re-approval might have triggered a review of the scheme, and led to the earlier introduction of controls. However, it would be wrong to conclude that the need for complete suspension could have been anticipated prior to April 2015.

16. Secondly, David asked about the Treasury changes to funding arrangements, and the respective effects in NI and GB. The effect in NI is well documented above. Whilst DECC has not shared detailed information, it is understood that GB expenditure is expected to remain within budget. As noted above, this reflects the relatively lower risk in GB, and the availability of demand-management controls without recourse to legislative change.

17. Thirdly, David asked for information on demand forecasting arrangements, and whether better forecasting might have prompted DETI to proceed to suspension, rather than introducing controls.

18. Forecasting was based on analysis of historical trends, and did not include any element of market research. It is now readily apparent that this was inadequate in the face of such short-run volatility of demand (coupled with long-term consequences).

19. It is not difficult to conclude that, with perfect information, DETI might have opted for suspension in July or September 2015. However, as noted above, it cannot be safely concluded that this would have obviated the difficulty, as the responsiveness of demand is capable of limiting the effectiveness of any new measure. The average lead-in time for a new RHI installation is 4 to 6 weeks. Given the normal timescale for consultation and the legislative process, there would have been ample opportunity for the poultry industry to ramp up demand before suspension could be introduced.

20. I will keep you apprised as matters proceed.

ANDREW MCCORMICK

DFE-153127

Annex

RHI TIMELINE OF COMMUNICATION

Item ref	TRIM reference	Content	Timescale
1	DT1/15/0120157	Submission to Private Office, seeking urgent cost control and administrative changes to the NI Renewable Heat Incentive (RHI) Schemes.	8 July 2015
2	DT1/15/0132370	Email from John Mills to Chris Stewart re queries from SpAd on proposed non domestic cost control measures.	11 August 2015
3	DT1/15/0143031	Submission Decision SUB-1075-2015 : ETI Committee RHI - Introduction of Cost Control Measures & Ensuring Effective Administration of Domestic Scheme.	3 September 2015
4	DT1/15/0189114	DFP approval for prospective RHI expenditure to March 2016. Non-Domestic Renewable Heat Incentive: Addendum -	29 October 2015
5	DT1/15/0175576	Submission to Private Office. Notification of Assembly motion re: the Renewable Heat Incentive Schemes (Amendment) Regulations (Northern Ireland) 2015.	6 November 2015 – cleared 10 November 2015
6	DT1/16/0000168	Sub - Future of Renewable Heat Incentive	31 December 2015 – decision conveyed orally
7	DT1/16/0003535	Response to SpAd queries on SUB-0001-2016 : Future of Renewable Heat Incentive.	7 January 2016
8	DT1/16/0015240	Email from Chris Stewart to John Mills confirming Minister's acceptance of recommendation on RHI at a meeting on 11 January	12 January 2106
9	DT1/16/0005996	Submission: Consultation on Closure of to RHI Schemes	19 January 2016 – approved [x].