RESTRICTED - POLICY

Minister: See Recommendations (i) - (v) for your approval.
Michael Duffy
9/8/10

Department of Enterprise, Trade and Investment
www.detini.gov.uk

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From:	Fiona Hepper
Date:	9 August 2010
1.	Andrew Crawford
2.	Arlene Foster MLA

AC 2/8 - I think we need to discuss press comms with officials before accepting recommendation (iv) & (v)

DETI SUB 364/2010

CONCLUSION OF THE STUDY INTO RENEWABLE HEAT AND NEXT STEPS

Issue:	**(i) To update you on the findings of the recent study into renewable heat in Northern Ireland;** **(ii) To seek your agreement on the way forward; and** **(iii) To ask you to issue a press release on renewable heat**
Timing:	**As soon as possible – the publication of the Executive summary is overdue and keenly awaited by stakeholders, including the ETI committee.**
Need for referral to the Executive:	**Any future renewable heat strategy will require Executive approval in due course.**
Presentational Issues:	**Key external stakeholders have for some time been seeking confirmation on the likelihood of a Renewable Heat Incentive (RHI) rollout in Northern Ireland. The announcement of an intention to support renewable heat would be strongly welcomed by the industry.** **A draft press release (cleared with Press Office) is attached at Annex D for your consideration.**
Freedom of Information:	**This submission is exempted under Section 35 of the Freedom of Information Act.**
Financial Implications:	**The funding mechanism for a RHI has yet to be agreed by HM Treasury. The likelihood is a UK wide tax/levy; it is hoped this will be clarified in the October budget.**

diary a discussion Ms 13/9.

	Arrangements for DETI to use the Northern Ireland share of any such funding for an RHI would have to be agreed with DFP.
Legislation Implications:	**DETI does not have statutory powers for renewable heat and therefore primary legislation will be required in due course. [It is not possible to amend the current Energy Bill at Committee stage as the Office of Legislative Counsel (OLC) has stated it would be outside the scope of the Bill.]**
PSA/PFG Implications:	**None at present, but it is likely that new PSA targets in relation to renewable heat will have to be developed.**
Statutory Equality Obligations:	**Not applicable.**
Recommendation:	**I recommend that you:**

i) Agree to publish the Executive Summary of the report into the development of renewable heat in Northern Ireland on the DETI website;

ii) Write to the DECC Secretary of State, Chris Huhne, seeking an update on the overall funding position for RHI and informing him about Northern Ireland issues. A draft is attached at Annex B for your consideration;

iii) Write to the Chair of the ETI Committee with a copy of the Executive Summary. A draft letter is attached at Annex C for your consideration;

iv) Agree to further economic analysis on a localised Renewable Heat Incentive being commissioned as soon as possible; and

v) Issue a press release announcing the report's publication and a commitment to develop a RHI, subject to a positive business case / economic appraisal and funding being available. A draft (cleared by Press Office) is attached at Annex D for your consideration.

BACKGROUND

You are aware that Energy Division appointed AECOM Ltd and Pöyry Energy Consulting in December 2009 to undertake a study into the potential for renewable heat in Northern Ireland. This work was commissioned in the context of

developments in both the EU and GB in regards to developing renewable heat markets. This was in response to the EU Renewable Energy Directive (2009/28/EC) requirement that 15% of energy consumption (electricity, heating, cooling and transport) must come from renewable sources by 2020.

2. Key aspects of the work were to undertake a comprehensive review of the Northern Ireland heat market, the establishment of an evidence based target and, consideration of incentive schemes for renewable heat technologies following the announcement by DECC that an RHI would be operational in GB from April 2011.

3. A final draft of the Renewable Heat report was submitted to Energy Division at the beginning of June 2010 and, following consultation with the Project Oversight Group, the report has now been agreed by the group and completed. The Executive Summary of the report is attached at **Annex A**, and a copy of the full report can be made available if you wish.

KEY FINDINGS

4. The study has concluded that:

   i) Achieving a 10% renewable heat share by 2020 is possible but will require **significant government intervention**. A 10% target for renewable heat should be adopted in the SEF and a strategy for the long term deployment of renewable heat should be developed;

   ii) The achievement of a 10% renewable heat target **cannot be solely achieved by DETI**. Due to the cross-cutting nature of this work there are a number of issues in the report that can not be taken forward by DETI but require other government departments such as DSD, DOE, DARD etc. to take the lead. It is recommended that a cross departmental 'Renewable Heat Strategy Group' which would include government representatives as well as others is established in due course to take this work forward.

   iii) Northern Ireland needs to develop a specific RHI scheme and further economic work is required to assess the actual incentivisation levels required. The GB Renewable Heat Incentive scheme appears to be inefficient for Northern Ireland, by over-incentivising some technologies and not encouraging the most cost-effective options;

   iv) In order to meet a 10% target Northern Ireland needs to decide to either agree that installations from 2009 will be eligible for support under a Northern Ireland RHI (as per the GB model), or, put in place short term financial measures to support the industry until such times as a longer term support mechanism is agreed.

REACHING A 10% TARGET

5. The report offers three possible options to encourage renewable heat in order to reach a 10% target by 2020.

i) **Large Industrial Sites** – The 17 large industrial sites identified in the study account for 22% of Northern Ireland's heat demand. There is significant potential for developing renewable heat in this sector as, moving only a few sites over to renewable heat would go a long way towards reaching a 10% target. A detailed study would be required for each site to determine the technical and economic viability. However achieving the target solely by this method does pose a risk due to the longer term uncertainties for each site.

ii) **Domestic and Commercial Market** – Analysis has indicated that renewable heat is already cost effective for a number of these consumers. In order to encourage the roll out of renewable heat technologies in these markets a specific RHI for Northern Ireland would need to be developed. This would give confidence to the market and could be targeted to ensure appropriate technologies were installed where most cost-effective.

iii) **Community based schemes** – Around one third of housing stock in Northern Ireland lies in areas where community based schemes (such as district heating) could be viable due to the high correlation between housing density and heat demand. The development of these schemes face a number of financial and non-financial barriers however should be considered as part of a long term strategy.

FUNDING ISSUES

6. A significant issue still to be addressed is the method of funding for the RHI across the whole of the UK. Although DECC are relatively advanced with their RHI preparations, we understand that the coalition government Ministers are looking again at the proposed RHI implementation plan. In the annual energy statement on 27th July 2010, Chris Huhne, Secretary of State for Energy and Climate Change, reiterated the Government's support for renewable heat. In response to concerns from the opposition that the RHI might be scrapped, the Secretary of State said that, in light of the fiscal position, decisions regarding the future of the RHI had to be taken as part of the spending round, however the RHI remained the best way to reach the existing targets set for renewable heat.

7. Under the last Government it was proposed to fund a RHI via a levy on heating fuel. However we understand from DECC that this is no longer a viable option, and an option now under consideration is some form of UK wide taxation. If the RHI is funded through a UK wide tax, then Northern Ireland should be entitled to a share through the Barnett Formula in the normal way. DFP would, therefore, need to grant permission to use the funds here for an RHI. Given the uncertainty surrounding the funding issue, I would recommend that you write to Chris Huhne, to seek urgent clarification on this matter. DECC officials have advised that the issue should be clarified by the October budget at the latest. A draft letter to Chris Huhne (to be copied also to Sammy Wilson MP MLA, Minister of Finance and Personnel) is attached at **Annex B** for your consideration.

8. In the unlikely case that a UK funding mechanism is not forthcoming, then it would fall to the Northern Ireland Executive to decide where funding for an RHI might come from. The scale of the cost of a RHI is dependent on the types and rates of incentives agreed. Initial analysis has shown that 10% renewable heat could be achievable at a cost of £2.5million per annum per % point up to 10% and then £8.8million per annum per % point after that. This cost would be the equivalent of around £25 on the average annual heating bill per annum. At this stage this is purely an estimate based on initial renewable heat curve analysis. The implementation of a RHI may have a cost range anywhere from £5 per bill to £95 per bill, depending on the tariffs set.

ADMINISTRATION OF A RHI SCHEME

9. Anyone eligible for RHI will receive a set payment every year for the next 20 years. The current model for the GB RHI is based on Ofgem administering the payments to RHI recipients. Initial discussions with Ofgem have indicated that the software design is at an early enough stage to allow modifications to be made to incorporate the administration of any Northern Ireland scheme, in a similar manner to how the NIRO payments are currently made. There are clear economies of scale to be gained by piggybacking on the administration system to be employed by Ofgem. However a decision would be required relatively soon so as to benefit from the least cost software options, amending software closer to the go live date will be more expensive.

10. Ofgem intend the verification and validation of the renewable heat installations to be through the Microgeneration Certification Scheme (MCS). You may recall that Sustainable Energy Branch has for some time been working with the microgeneration installers to encourage their participation in this UK wide EU notified scheme. It would be intended that compliance with the MCS scheme will be a mandatory requirement of any RHI scheme operating in Northern Ireland.

ALTERNATIVE FUNDING OPTIONS

11. The current announcement from DECC to support renewable heat installations from July 2009, leaves the renewable heat industry in Northern Ireland clearly disadvantaged. In order to offer the industry some signal of support there are two options :-

    i. Make a similar announcement to DECC that installations either from the date of the draft SEF publication (July 2009) or from now (August 2010) will receive support through a future RHI (should it prove viable) - this in itself may be enough to give the industry enough confidence to keep investing and offers a no cost solution in the short term; or

    ii. provide short term financial support to support renewable heat installations until such times as a RHI is implemented. An opportunity has arisen recently when the Energy Saving Trust (EST) briefed a number of interested parties/stakeholders on the model for a revolving loan scheme, similar to a model used by the Scottish Government.

12. The proposal at (ii) is that a modest loan fund, possibly around £3m, would be put in place by a consortium of funders. Based on the Scottish model this could initiate around 800 projects in the pilot year varying from insulation to biomass boilers. Householders would be offered interest free loans over a period of up to 8 years. The Scottish pilot appears successful to date with over £2m of the fund being committed in the first 8 months.

13. As the heat study has indicated that 61% of Northern Ireland's heat demand is in the domestic sector, the EST loan proposal has the attraction of allowing any DETI contribution to be ring fenced for renewable heat installations. You may recall that this was raised during the 17 June SEIDWG meeting, and we understand subsequently also at the DSD chaired fuel poverty group.

14. While this may have offered a most timely intervention, unfortunately Energy Division has now been advised by EU Programmes that a provisional allocation of £900k of ERDF funding held by Energy Division for renewable heat cannot, under the current EU guidelines for ERDF, be used when the beneficiary is a householder. This being the case, a bid for £900k (per annum over the CSR period) of mainstream capital has been made as part of the 2010 Budget exercise. **However, if you made a commitment to pursue a RHI from either July 2009 or August 2010, this smaller scale intervention would not necessarily be needed, although you may wish to still contribute to the loan fund to assist installation of other forms of renewable energy installations.**

LEGISLATIVE POSITION

15. Currently DETI has no statutory powers in relation to renewable heat. The ETI Committee has recently enquired whether or not the Energy Bill, currently with the Committee for consideration, could be amended to include provisions on renewable heat and specifically a renewable heat incentive.

16. The Office of Legislative Counsel has advised that as the Bill is principally about the gas industry, with a very limited application to the electricity sector, a provision for renewable energy is deemed to be outside the scope of the Bill. It will therefore be necessary for primary powers to be taken for renewable heat in a subsequent Energy Bill, currently being considered.

RENEWABLE HEAT AND NATURAL GAS MARKETS

17. Experience from Reconnect would suggest that the greatest uptake of domestic renewable heat technologies will be in rural off-gas grid areas. An extension of the natural gas network into the West/ North West of Northern Ireland has the potential to adversely affect the take up of renewable heat in areas that may have previously been likely to convert to renewable heat. While the development of the natural gas and renewable heat markets simultaneously will contribute positively to a lower carbon future, the fact remains that the extension of the natural gas network in the period up to 2020 may be a significant factor in determining how/if Northern Ireland will achieve its contribution to the wider UK renewable heat target. Consideration will need to be given as to how to ensure that the two markets can develop alongside each other without one adversely affecting the other.

18. In order to develop renewable heat in Northern Ireland consideration will need to be given to how indigenous resources can be maximised and utilised effectively. A mix of technologies and fuel types will also be required to reach a future 10% renewable heat target. Biomass in its many forms is available to a certain extent and is already present in the heat market, but competing demands for it in the future may affect the amount of renewable heat that can be delivered unless there is a significant expansion in energy crops. This is something that is outside DETI's remit, although the draft Bio energy Action Plan has already focused on the need to work closely with DARD in this area.

19. Similarly biogas generated from food and farm wastes and grass can be used to generate heat directly or can be injected into the gas network. The high proportion of grassland in Northern Ireland means that this technology could have significant potential. DETI already incentivises the production of electricity from biogas and anaerobic digestion, but both technologies also offer potential for heat generation.

20. Other forms of renewable heat such as deep geothermal, solar thermal panels, bio fuels and air and ground source heat pumps will also need to be encouraged if a 10% target is to be reached.

RECOMMENDATIONS

21. Over the last few months there has been an increased interest from MLA's, the ETI Committee and representatives of the industry and wider renewable energy lobbyists for a RHI in Northern Ireland. While the subject area is a complex one, needing further work, in the absence of any commitment on a RHI the renewable heat industry in Northern Ireland is currently disadvantaged compared to GB. It is expected that this will be a key aspect of the ETI Committee's inquiry into renewable energy in the autumn. For this reason I think it would be advantageous to advise the ETI Committee of progress to date in advance of the inquiry concluding. A draft letter to the Chair of the ETI Committee is attached at **Annex C** for your consideration.

22. I would recommend therefore that you agree to the way forward as outlined below :-

    i. Agree to publish the Executive Summary of the report into the development of renewable heat in Northern Ireland on the DETI website;

    ii. Write to the DECC Secretary of State, Chris Huhne seeking an update on the funding position for RHI and to update him on the Northern Ireland issues. A draft is attached at **Annex B** for your consideration;

    iii. Write to the Chair of the ETI Committee with a copy of the Executive Summary. A draft letter is attached at **Annex C** for your consideration;

    iv. Agree to further economic analysis on a localised Renewable Heat Incentive being commissioned; and

v. Issue a press release (to be cleared by Press Office) announcing the report's publication and a commitment to develop a RHI, subject to funding being available. A draft is attached at **Annex D** for your consideration (subject to clearance by Press Office).

vi. Re para 11(i): I suggest the date should be August 2010 as this is when we completed and published the NI RHI work. [Also, we would find it difficult to 'cost' the impact of working back to July 2009 at this stage].

23. In addition, Energy Division would propose to work with Invest NI to explore further the potential contribution from the 17 large industrial sites that account for around 22% of the total heat demand in Northern Ireland, 2 of which on their own account for over 14% of total Northern Ireland heat demand.

24. Given the many issues raised here I am happy to brief you further on any of the individual issues raised in this submission. I attach for your information:-

Annex A – Executive Summary of the report in to the potential for Renewable Heat in NI (attached separately);

Annex B - Letter to Chris Huhne, Secretary for Energy and Climate Change, DECC;

Annex C - Letter to the Chair of the ETI committee; and

Annex D – Draft press release (cleared by Press Office).

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