From: Marshall Jonathan (Office for Renewable Energy Deployment)
To: Hutchinson, Peter
Subject: RE: GB RHI and NI equivalent
Date: 06 June 2011 15:01:03

Peter,

As discussed, I've included contact details for the relevant people in DECC's finance team below along with some brief answers to your questions reflecting our earlier conversation. If you'd like to discuss any of these issues further once you have a steer from your minister then let me know and I'll see whether we can arrange a meeting via video conference in a few weeks time.

Thanks,

Jonathan

From: Hutchinson, Peter [mailto:Peter.Hutchinson@detini.gsi.gov.uk]
Sent: 03 June 2011 17:01
To: Marshall Jonathan (Office for Renewable Energy Deployment)
Subject: GB RHI and NI equivalent

Jonathan,

We are nearing the end of our economic appraisal into the NI RHI and I had some questions regarding the GB scheme.

In regards to financing the scheme, grateful if you could advise on the following;

- how is your money classified (DEL, AME or other) and how does this impact on unspent money being lost in future years? **Classified as AME. DECC's finance team - Akhil Patel (akhil.patel@decc.gsi.gov.uk) and Irrelevant information redacted by the RHI Inquiry@decc.gsi.gov.uk) - are looking at spending controls across all the DECC levies.**
- following on from this, how do DECC propose to manage potential underspends or overspends? I am assuming that the scheme won't temporarily close at any stage if it is over-subscribed?
- the GB RHI is open to 2020 however I understand that funding is only secure until 2015. Our funding is also only confirmed until 2015, what discussions have you held with HMT to provide the assurances necessary to keep your scheme open to 2020.
- I understand that your tariffs will automatically rise with inflation, will your yearly funding from HMT do likewise?

In regards to tariffs;

- Has there been any further consideration given to ASHPs? **These are included in the tender for the 2012 RHI.**
- The GSHP tariff includes deep geothermal, have you had any feedback on whether this tariff level is appropriate for this technology or a separate tariff should be included? **Stakeholders would like a separate (higher) tariff! Geothermal is also included in the tender for the 2012 RHI, but likely to be lower priority given the need to include domestic.**
- Are there any upper limits to the tariff on for large biomass? **No, all sizes are eligible.**
- What was the rationale in not allowing co-firing even though it is eligible under the RO? Was there any consideration in allowing co-firing in the heavy industrial sector where moving wholly to renewables straight away would have logistical and supply issues. **Simplicity for generators and Ofgem - RHI aimed at different client base to RO.**

In terms of objectives/outcomes;

- Has DECC developed any smart targets for the RHI? i.e. renewable heat deployed, number of installations, co2 savings, jobs/skills created, impact on fossil fuels?
- Are there any plans to specifically monitor or support district heating schemes? **New renewable district heating will be eligible for the relevant tariff for the central boiler and Ofgem will be collecting data on those that they accredit for the RHI. However, we are not seeking to support networks under the RHI due to the costs involved and issues over refurbishment, conversion, etc.**
- Has DECC made any assessment on the impact on fuel poverty or how renewable heat could be used to support those suffering from fuel poverty? **Funding the RHI via government spending rather than a levy on fossil fuel suppliers should mitigate the impact on the fuel poor. We can't have special tariffs for those in fuel poverty but see people living off gas grid who already pay more for their heat as a key area for renewable heat. An independent review of fuel poverty was launched in March and is due to report on the wider issues by Autumn.**

If you are able to provide some information on the above questions that would be greatly appreciated - a key issue is the fact that the GB scheme is open to 2020, we would obviously be keen to do likewise but it may be difficult without budget cover.

Also if you have any further information on your proposals for the domestic sector and the premium payments I would be grateful if you could provide - I noticed that you have recently gone to tender for consultants to carry out work on an economic appraisal specifically for ren heat support in the domestic sector.

Thanks in advance.

Happy to discuss.

Peter

Peter Hutchinson
Sustainable Energy
Department of Enterprise, Trade & Investment
Netherleigh
Massey Avenue
Belfast, BT4 2JP
Tel: 028 9052 9532 (ext: 29532)
Textphone: 028 9052 9304
Web: www.detini.gov.uk

From: Patel Akhil (Finance)
To: Hutchinson, Peter; Varsani Rita (Finance)
Subject: RE: Northern Ireland RHI - Funding arrangements
Date: 08 June 2011 17:36:03

Peter,

Good to hear from you.

Rita and I manage what is known as the levies control framework (LCF), which is a new framework which came in this year and which seeks to limit the imputed spend on levies policies (even though they are demand-led schemes etc). The RHI is not actually a levy as it is funded out of direct taxation but given that it is demand-led it is subject to similar controls as the main levies policies (the RO, Feed in Tariffs and the Warm Home Discount). Further information on the LCF can be found here and here.

I say this as policy specific points ought to be officially answered by the policy team.

On your questions: you'll have to ask the policy team what they have announced about the RHI. There is definitely an ongoing issue with HMT about what we say about spending beyond 2015. Of course, since generators receive a multi-year tariff there will definitely be some RHI spend beyond 2015, however you'll have to ask the policy team what we've said about the RHI being open to new generation beyond 2015 and at what level. Jo Greasley would be able to answer that.

On the second question: the AME budget for the RHI is an annual one and we currently do not have any ability to roll forward underspends. If we overspend against our budget then we would have to adjust the policy such that we underspent against our future annual budgets by a corresponding amount. So we are not automatically required to close the scheme if we overspend. However, if we do not manage to find these savings we would have to fund the residual overspend from DEL. Clearly, this represents a large financial risk on the department so the policy team is currently looking to develop a system of tariff degressions that could be deployed at key points to ensure (among other things) that we manage the risk of overspending against our budget.

The annual AME budgets do not rise in line with inflation, i.e. we bear the inflation risk (this is true of departmental budgeting anyway, so this is not a surprise).

I hope that this helps. My direct line is below should you want to follow up on these answers now or as your scheme is worked up.

Best wishes,

Akhil.

Akhil Patel | Levies Framework Manager
Department of Energy and Climate Change
Area 2B | 3 Whitehall Place | SW1A 2HD
0300 068 5359 | akhil.patel@decc.gsi.gov.uk

From: Hutchinson, Peter [mailto:Peter.Hutchinson@detini.gsi.gov.uk]
Sent: 08 June 2011 17:10
To: Patel Akhil (Finance); Varsani Rita (Finance)
Subject: Northern Ireland RHI - Funding arrangements

Akhil / Rita,

Jonathan Marshall kindly passed me your contact details so I could ask a couple of questions regarding the funding procedures for the Renewable Heat Incentive (RHI). I am currently working on the design and the development of a Northern Ireland incentive scheme, for this we have £25m over the spending period (£2m/ £4m/£7m/£12m) which was allocated from HMT/DECC on a pro-rata basis on the GB funding.

As we will shortly be finalising the scheme I had some questions about the funding arrangements for the GB RHI which might impact on the Northern Ireland scheme;

- Most importantly possibly, the GB scheme will remain open to applications until 2020 however funding is only secured for this spending period until 2015. Have there been discussions with HMT regarding funding post 2015 to provide the required confidence to state that the RHI will remain open until 2020? This will be an issue for Northern Ireland when we consult as we will have to say when the scheme will close to applications, if no funding is secure post 2015 it may be hard to state the scheme will remain open until 2020 similar to the GB scheme. This issue might also impact on the actual design of the proposed incentive scheme. Grateful if you could advise on this issue?
- Secondly, I understand that your funding is classified as AME. How does this impact on unspent money over the year, is this money lost or can it be rolled-over to the following year? Also how will you manage against overspend in your budget - i.e. could the scheme close temporarily if it was over subscribed?
- Finally (for now!), I understand that the GB tariff levels will rise with inflation, will your yearly funding from HMT do likewise?

Thanks in advance for your help in responding to these queries. As our scheme develops it might be useful to speak further about funding arrangements and monitoring.

Thanks,

Peter

Peter Hutchinson
Sustainable Energy
Department of Enterprise, Trade & Investment
Netherleigh
Massey Avenue
Belfast, BT4 2JP
Tel: 028 9052 9532 (ext: 29532)
Textphone: 028 9052 9304
Web: www.detini.gov.uk

The control framework for DECC levy-funded spending forms part of the Government's public spending framework, which the Treasury has responsibility for. Its purpose is to make sure that DECC achieves its fuel poverty, energy and climate change goals in a way that is consistent with economic recovery and minimising the impact on consumer bills. The control framework is available to view via the Treasury website. These supporting Questions and Answers provide more information on what the control framework is and its implications for new and existing policies.

QUESTIONS

Q. Which policies are covered by the control framework?

Q. Why are some energy and climate change policies treated as taxation and public expenditure?

Q. What is the purpose of the control framework?

POLICY CHANGES

Q. Under what circumstances will there be policy changes as a result of this framework, and will industry be consulted on policy changes?

Q. How will future policy changes affect existing investment decisions?

Q. When a policy is reviewed, how soon will the policy changes be implemented?

Q. Will any policies, currently under review, be reviewed again in the future?

RENEWABLES TARGETS

Q. How does the control framework work alongside the Renewables Delivery Plan?

SPENDING LIMITS

Q. What is the spending envelope for the policies within the Spending Review period?

Q. What happens if DECC thinks spend might be on course to exceed its envelope?

Q. Will DECC be publishing details on expenditure or projected expenditure?

NEW POLICIES

Q. In the future within the Spending Review period, will other energy and climate change policies be introduced within the framework? If they will, will the Spending Review limit stay the same?

RENEWABLE HEAT INCENTIVE

Q. Is the Renewable Heat Incentive (RHI) a levy, and how is RHI spending controlled?

Q. Which policies are covered by the control framework?

A number of government policies place the obligation of financing the policies onto energy companies, which is then passed onto the consumer. In the case of the three policies currently within the control framework, the consumer means energy bill payers. The policies are the Renewables Obligation (RO), Feed-In Tariffs (FITs) and Warm Home Discount (WHD). The Office of National Statistics (ONS) has classified the cost of the RO as a tax and the money that is spent on the renewable energy generation as public expenditure. The ONS are also considering the classification of FITs and WHD, but based on the ONS's rationale for its classification of the RO and an unofficial (and non-binding) initial view offered by the ONS, the Government judges that FITs and WHD are also likely to be classified as tax and spend and so has provisionally included them in the public finance aggregates.

Q. Why are some energy and climate change policies treated as taxation and public expenditure?

Because of the way they work. For example, the RO involves placing an obligation on energy suppliers to pay a premium to renewables generation. As this funding is mandated by the Government it is classified as public expenditure. The cost of the RO, which is passed through to energy consumers, is classified as a tax as the transfers are compulsory and not a direct payment for a good or service. The tax and spend generally net to zero automatically, with no money actually passing through Government. The final decision on which policies are judged to be tax and spend rather than regulation is made by the independent Office of National Statistics, based on the European System of Accounts 1995, and is not a decision for Government. However, Government does as standard make judgements on likely classification ahead of formal ONS decisions and provisionally reflect these as appropriate in public finance reporting.

Q. What is the purpose of the control framework?

The purpose of the control framework is to help ensure that these policies achieve their objectives cost effectively and affordably. Exceeding the spending on an ongoing basis could lead to an unsustainable increase in electricity bills, for example. The spending through the policies needs to be monitored so that we achieve our targets while managing tax and spend pressures within the economy. While we will aim to manage these policies to stay within cost limits, the control framework does provide some flexibility around these limits.

POLICY CHANGES

Q. Under what circumstances will there be policy changes as a result of this framework and will industry be consulted on policy changes?

Where a policy is forecast to overspend against the envelope, DECC will have to develop plans to bring spend back within the cap, taking into account impact on energy bills and progress towards our targets. How and how quickly these changes are implemented will depend on the various factors pertaining to the policy at the time; however, DECC will follow all required procedures such as statutory consultation and Parliamentary scrutiny.

Q. How will future policy changes affect existing investment decisions?

The Government is committed to its policy not to make retrospective changes and to maintain support levels for those existing investments where we have said we would do so. The control framework will not alter that policy, and is intended to enforce it, by ensuring that the affordability pressures of levy-funded spending policies are managed proactively to ensure they are affordable on a sustainable basis. This seeks to learn lessons from other countries where it has been deemed that support policies are no longer affordable.

Q. When a policy is reviewed, how soon will the policy changes be implemented?

If Ministers take a decision to adjust a policy, DECC will follow all required procedures, such as statutory consultation and Parliamentary scrutiny. Exactly how and when these changes will apply will be determined on a case by case basis.

Q. Will any policies, currently under review, be reviewed again in the future?

Regular review is a feature of all control framework policies. However, we recognise the importance of policy stability to provide the right incentives to secure the level of investment required to help meeting our targets.

RENEWABLES TARGETS

Q. How does the control framework work alongside the Renewables Delivery Plan?

The levy-funded policies are designed to meet our renewables targets. The control framework is designed to help ensure that these targets are met as cost effectively as possible.

SPENDING LIMITS

Q. What is the spending envelope for the policies within the Spending Review period?

The limits for the portfolio of levies policies, Renewables Obligation, Feed- In Tariffs and Warm Home Discount is £11.8bn over the Spending Review period (2011/12 to 2014/15). These are set out in the table below:

Policy	**2011-12 (£m)**	**2012-13 (£m)**	**2013-14 (£m)**	**2014-15 (£m)**
Renewables Obligation*	1,764	2,191	2,615	3,203
Feed-in Tariffs	80	161	269	357
Warm Home Discount	250	275	300	310

*This figure is based on an agreed HM Treasury-DECC methodology for the total support provided through the Renewables Obligation (RO). This differs from the Office of Budget Responsibility's (OBR) tax and spend forecasts as the OBR follows the Office of National Statistics (ONS) methodology for calculating tax and spend through the RO, which gives a lower figure. The ONS is currently reviewing its methodology.

Q. What happens if DECC thinks spend might be on course to exceed its envelope?

If we think that spend might be on course to exceeding its envelope (either in the short term or at some point in the future) we will consider making an adjustment to the policy, taking into account the impact on energy bills and progress towards our targets. Decisions on adjustments will be taken by Ministers at the appropriate time and will be judged on a case by case basis. A core principle through all of this is that the Government policy is to maintain support levels for those existing investments where we have said we would and not to make retrospective changes for these investments.

If Ministers take a decision to adjust a policy DECC will follow statutory and other required procedures.

Q. Will DECC be publishing details on expenditure or projected expenditure?

Ofgem publishes actual expenditure data in several publications (in the annual Renewables Obligation report or the quarterly Feed-In Tariffs updates; whether and when expenditure data on the Renewable Heat Incentive is published is yet to be determined). Ofgem will also publish an annual report on suppliers' spending under the Warm Home Discount scheme. The Office of Budget Responsibility will include their latest projections of tax and spend through DECC levies policies in their twice yearly economic and fiscal forecasts.

NEW POLICIES

Q. In the future within the Spending Review period, will other energy and climate change policies be introduced within the framework? If they will, will the Spending Review limit stay the same?

If other DECC policies are classified by the Office of National Statistics as tax and spend and yet are deficit neutral then they will fall within the control framework. How new policies are accommodated within the control framework will be determined on a case by case basis, but the general presumption is that new policies will not be introduced outside of a Spending Review process unless they would leave central projections of overall spending within the agreed cap.

It is too early to say whether the new Electricity Market Reform policies will be classified as levies and therefore subject to the control framework.

RENEWABLE HEAT INCENTIVE

Q. Is the Renewable Heat Incentive (RHI) a levy and how is RHI spending controlled?

The spending under the Renewables Heat Incentive is subject to a separate budgeting framework than DECC's levy-funded spending policies, as spending through the RHI is funded from general taxation and therefore it has a direct impact on government borrowing and debt. The RHI budgeting arrangements aim to keep annual spending to the agreed profile, but recognise that there may be some short-term fluctuations that cannot be rigidly capped. Overspends in the short-term will therefore be allowed but will need to be offset by savings below the profile in future years.

The Government is committed to its policy not to make retrospective changes and to maintain support levels for those existing investments where we have said we would. Where a policy is forecast to overspend against the cap, DECC will have to develop plans to bring spend back spending within the cap. How and how quickly these changes are implemented will depend on the various factors pertaining to the policy at the time; however, DECC will follow all required procedures such as Parliamentary scrutiny.

The agreed limits for the Renewable Heat Incentive over the period are set out in the table below.

Policy	**2011-12 (£m)**	**2012-13 (£m)**	**2013-14 (£m)**	**2014-15 (£m)**
Renewable Heat Incentive	56	133	251	424

DFE-62088

HM TREASURY

Control framework for DECC levy-funded spending

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HM TREASURY

Control framework for DECC levy-funded spending

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Contents

1 Introduction

1.1 The purpose of the Control framework for DECC levy-funded spending ("the control framework") is to make sure that DECC achieves its fuel poverty, energy and climate change goals in a way that is consistent with economic recovery and minimising the impact on consumer bills.

1.2 The 2010 Spending Review set an overall cap for DECC's tax and spending through policies that entail levy-funded spending. This cap will be managed though the control framework. It therefore requires DECC and the Treasury ("the departments") to ensure that they are focused on achieving these goals efficiently while safeguarding investor and stakeholder confidence.

1.3 The implementation of the control framework will be consistent with relevant legislation, regulations, the Treasury guidance - *Managing Public Money* - and Government policy announcements. The Government remains committed to maintaining support levels for those existing investments where it has said it would do so and not to making retrospective changes.

1.4 The Treasury has responsibility for the Government's public spending framework, and the control framework forms part of that. Therefore any changes to the Treasury's budgeting framework may also apply to those polices covered by the control framework.

2 Scope of the control framework and the cap

2.1 The control framework will include all DECC's existing or new policies which entail levy-funded spending.

2.2 Where tax and spend through a policy is not entirely within DECC's control due to its devolved nature (as with the Renewables Obligation) then allowance will be made for the element of spend outside the scope of this framework. Levy-funded spending will not be regarded as a regulatory burden to be covered by the 'One-in One-out' commitment, but as taxation and spending overseen by the Treasury.

2.3 Spending within the cap will be ring-fenced, i.e. cannot be used for spending elsewhere. Caps shall be annual unless agreed otherwise.

2.4 DECC will then need to set policy such that the central forecast for DECC levy-funded spending is equal to or less than the agreed cap. This will be informed by individual forecasts for tax and spend associated with each policy, with estimates produced by DECC and agreed as necessary by the Treasury and verified by the Office of Budget Responsibility. The Treasury will have full access to the methodology behind these estimates.[1] On a periodic basis (and at least annually) DECC will prepare updates of forecast income and expenditure on a policy-by-policy basis, as well as the latest outturn figures. These will be readied in the run-up to each fiscal event and signed-off by DECC's Chief Economist. DECC and the Treasury will agree at the outset a range of acceptable headroom above the cap, which will represent the level of permissible variation before DECC has to develop urgently plans for bringing policies back into line with the cap. The Treasury may seek a financial contribution from DECC should a satisfactory reduction plan not be brought forward. The acceptable headroom will initially be 20 per cent of the total cap but will be reviewed during the Renewables Obligation Banding Review and the Feed-in Tariffs Comprehensive Review.

2.5 Should DECC begin a Spending Review period with a policy mix that has a forecast tax and spend below an agreed cap, or has previously introduced changes that resulted in a net reduction in tax and spend, then the cap would remain the same, leaving headroom for future cost increases due to policy changes.

[1] Where appropriate, as with the Warm Home Discount, the magnitude of expenditure will be set out in the relevant regulations.

3 Exceeding the cap

3.1 Should exogenous factors or updated analysis result in forecasts or actual spend that is greater than the agreed cap, then the Treasury will need to be satisfied that there is a robust, agreed plan in place to bring spend back down to within the cap, even where forecasts remain within the acceptable headroom. However, where forecasts suggest that an overspend is temporary and within the headroom then the Treasury and DECC may jointly choose to agree that no action is necessary.

3.2 Where forecast or actual spend exceeds the agreed cap then the presumption will be that the Treasury will deny any changes to policy that do not seek to bring this forecast down, even if such changes are cost-neutral.

3.3 DECC will be able to maintain the levy-funded spending within the acceptable headroom without the Treasury's permission, so long as the additional spend is not the result of intended policy changes. As set out in paragraph 3.1, an agreed plan for addressing the overspend will still be required but this may be less aggressive than if the headroom is exceeded.

3.4 Where spend exceeds or is projected to exceed the range of acceptable headroom, DECC will rapidly agree with the Treasury a plan for bringing spending back down to the agreed profile. This plan will set out the adjustments that DECC proposes to make to its policies to reduce their spend, and the impact by year of taking action. The departments recognise the duty to follow statutory and other requirements before making adjustments and the need to maintain levels of support where it has said it would do so.

3.5 The Treasury will need to agree this plan, and may refuse to do so where it does not have confidence in its efficacy in returning spend to within the cap. The absence of an effective plan could ultimately result in the Treasury refusing DECC permission to retain all or part of the tax income received above the agreed cap, which would leave DECC to fund all or part of the spending gap from within its Departmental Expenditure Limit.

3.6 If for non-policy reasons central forecasts fall below the cap on a sustained basis then the cap will be revised downwards in line with revised forecasts where analysis shows that changes are not the result of 'noise' or temporary movement, unless there is agreement on the need to maintain the cap because deployment has undershot expectations such that Government objectives may not be met.

4 Changes to the policy mix

4.1 DECC will retain the right to make changes to policies within the framework. The Treasury will need to approve changes where proposals:

- entail any changes to specific policies that has a gross annual impact that is more than DECC's standard delegated limit;
- could create pressures leading to a breach of the levy envelope in the Spending Review period;
- could increase long-term cost pressures beyond those previously envisaged;
- impact on how costs will be borne, including where there could be significant tax policy or welfare impacts (eg change in tax base);
- could set a potentially expensive precedent;
- could cause significant repercussions for others; or
- are novel or contentious.

4.2 Where these criteria are met as a result of significant cost or tax policy or welfare impacts then changes would usually need to be made at a fiscal event or Spending Review. For changes that result in central projections that remain within the cap then the strong presumption will be that such changes will not be overruled on affordability grounds. Therefore, changes that increase expenditure by one policy will generally be accompanied by offsetting savings in another such that, overall, policy remains within the overall and any ring-fenced caps.

4.3 There would be a strong presumption that agreement would not be given outside of a Spending Review process for changes that take central projections above the agreed cap– including for additions of new policies to the framework. How new policies are accommodated within the control framework will be determined by the departments on a case by case basis.

5 Reviewing the agreed cap

5.1 The cap will not increase in line with changes in forecast tax and spending due to non-policy reasons (including forecast error), for example, higher than expected deployment of renewable energy installations or higher than expected uptake of state benefits used to confer eligibility for fuel poverty payments.

5.2 Aside from possible reductions in the cap due to non-policy reasons, the strong presumption will be that the cap will only be reviewed as part of a Spending Review. However, there may be exceptions to this, including if there are significant changes to the energy tax regime which have knock-on effects for DECC's policies which entail levy-funded spending.