Mr Jim McManus
ETI Committee Clerk
Northern Ireland Assembly
Parliament Buildings
Stormont
BELFAST
BT4 3SW

March 2012

Dear Mr McManus

SL1 – RENEWABLE HEAT REGULATIONS (NORTHERN IRELAND) 2012

1.1 The Department of Enterprise, Trade and Investment (**the Department**) proposes to make a Statutory Rule in exercise of the powers conferred by the Energy Act 2011.

1.2 The Department of Energy and Climate Change (**DECC**) in London agreed that an amendment could be made to the Energy Act 2011 that would extend powers for renewable heat, contained within the Energy Act 2008, to Northern Ireland. For this to be achieved a Legislative Consent Motion (**LCM**) was required. Following Executive approval on 10 February 2011 and ETI Committee support at its meeting on 24 February 2011, a LCM was tabled and passed in the Assembly on 14 March 2011.

1.3 The Energy Act makes special provisions for Northern Ireland in terms of renewable heat[1].

1.4 DECC obtained Royal Assent on 18 October 2011 and the Bill became the Energy Act 2011. The Act deems that the Statutory Rule will be subject to the affirmative resolution procedure before the Assembly.

Purpose of the Statutory Rule

2.1 The Department carried out an economic appraisal of a potential Northern Ireland incentive scheme with the aim to assist in achieving the target of 10% renewable heat by 2020. The appraisal considered various options for incentivising the local renewable heat market, and advised on appropriate tariff levels. It also considered the costs/benefits and the impact of each of the options.

2.2 The Department carefully considered the findings of the economic appraisal to reach a view on the proposed design of an incentive scheme for Northern Ireland (NI) and has obtained Ministerial clearance on the proposed way forward.

2.3 The Statutory Rule has therefore been drafted based upon equivalent Regulations in GB which are entitled the Renewable Heat Incentive Regulations 2011 (**the GB**

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[1] Sections 113 and 114 of Energy Act 2011 - http://www.legislation.gov.uk/ukpga/2011/16/part/3/crossheading/northern-ireland-renewable-heat-incentives/enacted

Regulations)[2]. The GB Regulations were approved by both Houses of Parliament and by Scottish Ministers on 10 November 2011.

2.4 The Statutory Rule will set in place a structured mechanism which will allow a RHI scheme to be introduced which will provide long-term guaranteed financial support for renewable heat installations in Northern Ireland. The Rule will underpin the tariff scheme and will specifically prescribe matters relating to eligibility criteria, obligations for participants of the scheme, methods of payment and accreditation and registration.

Consultation

3 The Department went out to consultation on a proposed RHI scheme including the draft Statutory Rule on 20 July 2011, closing on 3 October 2011. A number of consultation seminars were also held over the summer period. In total, 78 formal responses were received, of which two offered no comment. The responses have been analysed and the vast majority of respondents were in favour of the proposals and provided useful comments which the Department considered and, where appropriate, incorporated in the final design of the scheme.

Position in Great Britain

4 DECC originally legislated for an incentive scheme in the Energy Act 2008 and has established the GB RHI scheme and provided details of the manner and design of such a scheme. In March 2011, DECC published further information on the RHI where it advised that the Office of the Gas and Electricity Markets (**Ofgem**) is responsible for developing and administering the scheme on behalf of DECC. DECC obtained parliamentary approval of the GB regulations in November 2011.

Equality Impact

5. In accordance with the requirements of Section 75 of the Northern Ireland Act 1998, a screening exercise has established that the proposed Regulations do not have any implications for equality of opportunity, and are instead engineered to promote equality of opportunity.

Regulatory Impact

6.1 A draft Regulatory Impact Assessment (**RIA**) has been prepared in respect of these Regulations. The Regulations will support the implementation of the Renewable Energy Directive 2009/28/EC (**RED**) which requires the UK to ensure that 15% of its energy consumption comes from renewable sources including electricity, heating and cooling and transport.

[2] http://www.legislation.gov.uk/ukdsi/2011/9780111512753/contents

6.2 Five options were considered as part of the RIA –

(a) Do Nothing

It was determined that under this option there would be limited deployment of renewable heat, the amount of which would largely be dependent on fossil fuel prices and the understanding of renewable alternatives. It was estimated that by 2020 renewable heat would account for around 4.8% of heating demand if no financial support was available. This option is not deemed as viable for a number of reasons. Firstly, the target set in the Strategic Energy Framework (**SEF**) for renewable heat would not be met and the funding provided by Her Majesty's Treasury (**HMT**) (discussed under point 7) would not be used. Secondly, the Northern Ireland renewable heat market would be distinctly disadvantaged in comparison to Great Britain and there would be a potential loss of skills and expertise to the Great Britain market. Finally, there would be widespread criticism of the Department if no action was taken, especially given previous commitments on the issue.

(b) A renewable heat challenge fund

A 'Renewable Heat Challenge Fund' would be a capital grant with the grants being awarded on a competitive basis, rather than 'first come first served'. In this scenario interested parties would be invited to apply for funding and would provide information on the intended installation, expected heat output and required funding (there would be a maximum allowed grant based on % of total cost). Applications would then be ranked based on the cost-effective renewable heat output and grants awarded according to rank. This process would be repeated on either a bi-annual or annual basis.

There are several issues to consider under the challenge fund option. The scheme would need to be administered either by the Department or a contracted third party organisation and therefore could result in additional resource pressures or governances issues. It could also be potentially complicated and would require applicants to have an understanding of their heat demands and most appropriate technology requirements. There would also be a danger that only certain technologies, which ranked highly on the scoring matrix, would be incentivised, namely air source heat pumps or biomass boilers; this could be controlled by the Department in designing the scheme. However, this would not support the development of a more diverse market and could have a negative impact on technologies that require more support, e.g. solar thermal.

The final issue with a 'challenge fund' is that it is in essence a capital grant system and does not provide long term stable support. Previous experience shows that grant schemes tend to lead to the market ramping up but then failing once the funding ends. It is also not certain that such a fund would be in the spirit of the terms under which HMT is providing the funding.

(c) 50% capital grant
The option considered would be a 50% grant to cover the capital costs of various renewable heat installations. Under this scheme 5.35% renewable heat could be delivered by 2015. If a grant scheme is the preferred option then a challenge fund scheme would be the preferred option and would ensure deliver more cost effective renewable heat. Lessons learned from the *Reconnect* scheme would support the view that a competitively awarded grant can be more cost-effective and targeted than an administratively awarded grant.

(d) Joining in with the GB RHI scheme
There are many positives for joining in with the existing GB RHI including the consistency of approach with GB, savings in the cost of administrating an NI scheme, and the potential speed with which a scheme could be implemented.

However, it has been concluded that, given the differences between the GB and Northern Ireland heat markets implementing the GB RHI as it is currently devised and using the proposed GB tariffs in Northern Ireland would not be appropriate. The major issue that would arise would be that customers could be potentially over-incentivised and inefficient technologies supported; there would also be an unintended negative impact on the gas market. The GB tariff levels are largely based on the assumption of a household or business switching from gas to renewables. Whereas, given the prevalence of oil in Northern Ireland, tariff levels for a Northern Ireland scheme would need to be set on the assumption of moving from oil to renewables. If GB tariff levels were implemented there would potentially be an incentive for existing gas customers to switch to renewables and not just those using oil. Under statute, DETI has an obligation to develop and maintain an efficient gas industry and therefore it is important to develop tariff levels that make it attractive for oil customers to switch but not necessarily existing gas users.

(e) A specifically tailored NI RHI scheme
The NI RHI option offers the highest potential renewable heat output at the best value. It also would incentivise a wide range of technologies and provide investors with long-term support. Whilst it would only be open to non-domestic market, in the first instance, it would eventually be open to all consumers and therefore provide greater accessibility.

The purpose of the RHI (in GB and NI) is to incentivise people to move from carbon-based heating to renewable energy sources. The ‘cost’ of the carbon fuel is therefore important and differs in the GB and NI markets. The tariffs for the Northern Ireland scheme are therefore lower as they are based on moving people from a more expensive fuel source, therefore the required incentive to move is deemed to be lower. In addition, the tariffs are based on an oil counterfactual, increasing the tariff levels could lead to consumers currently on gas switching to renewable heat, this would not be desirable as it could lead to long term price increases in gas distribution charges.

Similar to the GB scheme, the NI RHI would be made available to the non-domestic market first, with the domestic market introduced at a later date. The reason for this is difficulties in assessing and monitoring heat demand in domestic dwellings. DECC is currently considering the incentives for the domestic market. The Department's consultation also highlighted a commitment to consider this issue and introduce the RHI to the domestic market as soon as possible.

6.3 Preferred option
As mentioned in the consultation exercise in July 2011, the Department's preferred option is a specifically tailored NI RHI scheme. This has been determined as the most appropriate method of providing long term support for the local industry, with tariffs developed specifically for the Northern Ireland heat market which will utilise available funding most efficiently. The Department also anticipates that there will be secondary benefits to the development of the renewable heat market other than increased renewable uptake. These associated benefits include a reduction in CO_2 emissions as fossil fuels are displaced, an increase in fuel security as Northern Ireland's dependence on imported heating fuel diminishes and growth for 'green jobs' as companies benefit from opportunities presented by renewable heat.

Financial Implications

7. HMT has advised that £25m of funding will be made available for a Northern Ireland RHI. This funding is spread over the spending period between 2011-2015, with £2million in the first year, followed by £4million and £7million, with £12million available in the final year. The funding will come from direct Government expenditure and therefore will have no impact on Northern Ireland consumers' energy bills.

EU Implications

8.1 The RED requires the UK to ensure that 15% of its energy consumption comes from renewable sources – for the first time the requirement extends beyond electricity to heating and cooling and transport. This is an important shift in emphasis: almost half of the final energy consumed in the UK is in the form of heat, producing around half of the UK's CO_2.

8.2 The RED is the key driver for the work undertaken by the Department on renewable heat. The requirement to meet the very challenging 15% renewable energy target falls at Member State level, not at Devolved Administration (**DA**) level. However, while energy is a devolved matter for Northern Ireland, each DA is expected to contribute as much as possible to the overall UK target. In light of the obligations within the RED, the Department has undertaken to introduce a renewable heat scheme in Northern Ireland.

Section 24 of the Northern Ireland act 1998

9. The Department has considered section 24 of the Northern Ireland Act 1998 and is satisfied the proposed Rule does not contravene the Act.

Section 75 of the Northern Ireland Act 1998

10. The Department had considered section 75 of the Northern Ireland Act 1998 and is satisfied that the proposed Regulations will have no negative implications or possible infractions under Section 75.

Operational Date

11.1 It is proposed that the Regulations will come into operation in May [TBC] 2012.

11.2 I would be grateful if you would bring this matter to the attention of Enterprise, Trade and Investment Committee.

Yours sincerely

Fiona Hepper
Head of Energy Division

cc Human Rights Commission
Legislative Programme Secretariat