

From: [McCutcheon, Joanne](#)
To: [Hepper, Fiona](#)
Cc: [Hutchinson, Peter](#)
Subject: FW: SA.34140 - RHI State aid decision
Date: 16 October 2013 09:08:54
Attachments: [image005.jpg](#)
[image006.png](#)

As suggested by Paul, I spoke to Stephen Moore yesterday. At first he thought there was a way round problem by showing that there was no over compensation. However, he has considered further - please see the two e-mails below – particularly his suggestion that the scheme should be suspended. I am in the middle of trying to establish the position re carbon trust loans.

Joanne

From: Moore, Stephen (DETI) [mailto:Stephen.Moore@detini.gsi.gov.uk]
Sent: 15 October 2013 19:36
To: 'Joanne.McCutcheon@detini.gsi.gov.uk'
Cc: Pauley, Alberta; Ryan, Damien; Brush, Paul
Subject: Re: SA.34140 - RHI State aid decision

Joanne

Further to my earlier email. I did not make it clear that I am assuming the loans from the Carbon Trust are either made on the basis of the de minimis regulation or are Regional aid or are some other type of State Aid.

If yes, then we have a cumulation problem.

Therefore perhaps the first question to clear up is whether the loans are de minimis or Regional aid or something else altogether e.g. Risk capital?

Stephen

This was sent from my Blackberry Device.

From: Moore, Stephen (DETI)
Sent: Tuesday, October 15, 2013 05:51 PM
To: McCutcheon, Joanne <Joanne.McCutcheon@detini.gsi.gov.uk>
Cc: Pauley, Alberta; Ryan, Damien; Brush, Paul
Subject: SA.34140 - RHI State aid decision

Joanne

Further to our quick chat. I've now had a chance to read through and remind myself what was in the Commission decision and the 2008 Environmental Aid Guidelines.

At first glance it is not good news (see paras 46, 59 and 71 of the RHI decision) , but it is not a complete disaster either.

At first I had hoped we could simply argue there has been no overcompensation, but I am not sure this is sustainable.

Because of the no cumulation commitment we effectively gave (see RHI decision letter), even if there is no overcompensation (i.e. the rate of return is less than 12% or even between 8% and 22%), if the EC were to investigate and even if it is happy with actual rates of return, I suspect (at the very least) it would 'regret' the UK has not complied with the conditions in the decision.

Whether it would also say the loans by Carbon Trust were illegal and require them to be recovered is the big unknown.

I expect the EC's view on this would depend on the effect of the loans on the actual rate of return in each individual project.

However, it may not be all bad and, in theory, we could still argue that although we did not want to cumulate, we have been forced to back down on this (e.g. because of market conditions) and understand that the EC is prepared to allowed cumulation in certain circumstances.

In particular you will see RHI was assessed against para 109 (Option1) in the 2008 Environmental Aid Guidelines and that para 109(b) does allow cumulation providing "*any investment aid granted to the undertaking in question in respect of the new plant must be deducted from production costs when determining the amount of operating aid.*"

(NB – ROCs was assessed against para 110 – Option 2 in the EAG – which means there are no parallels we can draw)

Para 109 is as follows...

Option 1

a) Member States may grant operating aid to compensate for the difference between the cost of producing energy from renewable sources, including depreciation of extra investments for environmental protection, and the market price of the form of energy concerned. Operating aid may then be granted until the plant has been fully depreciated according to normal accounting rules. Any further energy produced by the plant will not qualify for any assistance. However, the aid may also cover a normal return on capital.

b) Where aid is granted in accordance with point (a) any investment aid granted to the undertaking in question in respect of the new plant must be deducted from production costs when determining the amount of operating aid. When notifying aid schemes to the Commission, Member States must state the precise support mechanisms and in particular the methods of calculating the amount of aid.

c) Unlike most other renewable sources of energy, biomass requires relatively low investment costs, but higher operating costs. The Commission will, therefore, be amenable to operating aid for the production of renewable energy from biomass exceeding the amount of investment where Member States can show that the aggregate costs borne by the undertakings after plant depreciation are still higher than the market prices of the energy.

In other words, when there has been an investment grant (e.g. the Carbon Trust loan), in theory, Ofgem could reduce the amount of operating aid i.e. reduce the RHI tariff level by an

appropriate amount to ensure no overcompensation.

Next steps?

Clearly Ofgem is at fault as it should not have agreed that the Carbon Trust could provide the loans. The Carbon Trust is also at fault as it should have been aware of and considered the effect of its loans on the conditions in the RHI decision.

Therefore, both Ofgem and the Carbon Trust need to understand the problem they have created and to propose and agree a solution with DETI.

However, as a minimum, the following options seem to be open.

- (a) The Carbon Trust or Ofgem must inform those who have received the loans that this was a breach of the conditions of the State aid approval and the loans will have to be fully repaid to the Carbon Trust or they will no longer be eligible to receive any RHI support.
- (b) DETI tells the EC that Ofgem has inadvertently breached the terms and conditions of the State aid decision and ask them to amend this to allow cumulation.

Given the presentational difficulties, I am not sure that (a) would be acceptable to Ministers.

If we go down the (b) option, we will need to look quickly and closely at whether there is a sustainable argument that the rate of return as a result of cumulation has not been (and will not be) excessive (e.g. in the range 8% – 22%). We should also consider how Ofgem might improve its assessment process to ensure any such cumulation in the future will not result in overcompensation. Finally, unfortunately, we should probably suspend the scheme.

Happy to discuss.

Stephen

Stephen Moore

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