



INQUIRY INTO THE RENEWABLE HEAT INCENTIVE SCHEME

Supplementary Statement addressing issues arising from Ofgem evidence

DATE: 21 September 2018

Witness Statement of: Brendan McCann

I, Brendan McCann, will say as follows:

1. This statement by the Department for the Economy (DfE) supplements the statement of Stephen McMurray dated 26 October 2017 (**WIT-03039**), which in turn supplements earlier statements including the main DfE corporate statement dated 19 May 2017 (**WIT-00019**). The 26 October 2017 statement provides background to the involvement of the Office of Gas and Electricity Markets (Ofgem) in the NI RHI Scheme, at paragraphs 157-202 (**WIT-00069 to WIT-00084**) and 231-256 (**WIT-00093 to WIT-00102**). The 19 May 2017 statement addresses a number of specific issues arising from the witness statement provided to the Inquiry by Dermot Nolan on behalf of Ofgem (**WIT-95013**).
2. While both the 19 May 2017 and the 26 October 2017 DfE statements touch upon the role of the Office of Gas and Electricity Markets (Ofgem), a significant volume of relevant additional evidence has been adduced since the 26 October 2017. It would be inappropriate for the Department to seek to comment upon every aspect of that evidence, or to trespass upon ground which has been comprehensively covered by the Inquiry, however there are a number of areas in which the Department considers that it can usefully add to the evidence already before the Inquiry, in the context of the Department's involvement with Ofgem.

Structure of the Department's Response

3. In providing this supplementary statement, the Department aims to address certain matters arising from evidence which has been provided to the Inquiry,

touching upon the role of Ofgem. In hopes of achieving a coherent structure, points have been grouped under the following themes:

- a. Ofgem's role in the NI RHI Scheme
- b. Ofgem communication with DETI
- c. Risk Management
- d. Fraud and Compliance
- e. Comparison between Ofgem's administration of the GB RHI Scheme on behalf of DECC, and its administration of the NI RHI Scheme on behalf of DETI

4. The Department acknowledges that DETI reserved responsibility for designing the policy underlying the Northern Ireland RHI Scheme and primary responsibility for the key judgments rested and rests with DETI/DfE. Nothing in this statement is intended to detract from that clear position stated on behalf of the Department. However, the Department was nonetheless entitled to place a degree of reliance upon Ofgem, particularly in light of Ofgem's greater experience of RHI type schemes. A desire to benefit from Ofgem's experience was a significant consideration for the Department, from an early stage. The evidence provided to the Inquiry to date causes the Department some concern in relation to the service provided to it by Ofgem, particularly in respect of the extent, or otherwise, of Ofgem's communication and openness with the Department. A determination as to whether or not the Department was well served by Ofgem, and, if not, whether that made any difference to the problems and progression of the NI RHI scheme, is a matter for the Inquiry. It is hoped that this statement will assist the Inquiry in understanding the Department's position, in the context of the Ofgem evidence.

Ofgem's role in the NI RHI scheme

5. Ofgem has repeatedly stressed the limitations of its role in the NI RHI scheme (e.g. paragraph 223 (**WIT-95068**) of Dermot Nolan's statement states,

"As an administrator of the NI RHI Scheme we (Ofgem) had no function under the Regulations of providing advice to the Department. It was our function to administer the scheme and report the information we were required to report under the Arrangements. It was for the Department to

consider and assess that information and the impact it may have had on their policy in relation to the Scheme”.

6. Similarly, Jason Beer QC at paragraph 38 of his opening statement for Ofgem, asserted the following distinctions between the Department and Ofgem:
 - i. A **functional** distinction i.e. *“Ofgem did not have a policy development role in relation to this Scheme. It did provide advice on how the Department’s policy could best be translated into a legislative scheme and, as we shall see, advised the Department firmly of the risks of seeking to implement that policy in regulations that mirrored the GB regulations at a time when the deficiencies in the GB regulations were well known, understood, and in the process of being addressed by amendment.”*
 - ii. A **temporal** distinction i.e. *“once the Regulations had been enacted, once the Department had made a clear policy choice to proceed with the Scheme in the unamended GB format, Ofgem’s role was to administer the Scheme according to its terms, including the flaws in it. Neither the Regulations nor the Administrative Arrangements provided for Ofgem to undertake any kind of superintendence of the Scheme, and nor was that the common understanding of the parties.”*

7. The Department has two concerns arising as a result of the way in which Ofgem has presented its role in the NI RHI Scheme to the Inquiry. The first issue is whether the distinctions and limitations relied upon by Ofgem in the foregoing paragraphs are in fact borne out by an examination of the evidence. The second issue is whether Ofgem’s position as set out above, to the effect that Ofgem warned DETI of the risks before the Regulations were enacted, and its role thereafter was simply to administer the Scheme without any further obligation whatsoever to warn or alert DETI, regardless of Ofgem’s own state of knowledge, is consistent with the responsibilities of one public body to another.

8. Contemporaneous documents shed some light upon the nature and scope of the role envisaged for Ofgem in the NI RHI Scheme. The “Feasibility Study Briefing” (**OFG-170778** to **OFG-170796**) is an internal Ofgem document, in respect of

which, the Department is not aware of any evidence showing that the document was shared with DETI staff. In this document, (**OFG-170780**) Ofgem envisages a clear role for itself in the oversight and development of the NI RHI Scheme, specifically including a proactive monitoring role for Ofgem, through the Board, throughout the operation of the Scheme:

“In addition to Ofgem’s internal governance structures we have proposed a Joint Ofgem DETI Administration Board to oversee the development of the NIRHI Scheme, make decisions around key issues that may arise and manage the contingency fund.

DETI staff have expressed concerns about oversight of the Scheme and particularly controlling Scheme costs. At present there are no mechanisms for cost control (such as a trigger to notify when a certain number of applications have been received or an installation capacity limit has been reached).

Whilst in Belfast Catherine and Matthew discussed the option with DETI of this board continuing to meet on a quarterly basis throughout the operation of the scheme to monitor the costs, uptake and any issues arising...This will enable DETI/NIAUR to be proactive in making adjustments to the Scheme in the event of higher than expected uptake rather than reactively making changes to the Scheme once costs have already exceeded the scheme budget.”

9. Catherine MacArthur of Ofgem highlights that the Joint DETI-Ofgem Administration board was intended, at the time of the drafting of the feasibility study, to perform a scrutinising and monitoring role throughout the lifetime of the Scheme (**WIT-101328**);

“The feasibility study also proposes governance and detailed reporting arrangements to ensure that DETI had appropriate information and oversight of the scheme, and particularly scheme costs. In the feasibility study (para 6.11) I proposed a joint DETI-OFGEM administration board that would meet on a quarterly basis to scrutinise the scheme function and

monitor uptake during both the development and operational phases of the scheme”.

10. Catherine McArthur also gave relevant oral evidence to the Inquiry about the purpose of the Board and Ofgem’s role on it (Transcript Day 28 P.78)

“Dr MacLean: So the discussions that you were having, were they about what generally can be done about cost controls, or were they more specifically about what DETI’s expectations were of what Ofgem was going to do in order to control costs?

Ms McArthur: It was more general, and I think that, in response to the general concern, we then suggested some mechanism such as this — the board — to address that.

The Chairman: That was your answer to it: let’s have this board. Is that right?

Ms McArthur: Yes.”

The Department regrets that this joint RHI Administration Board never came into being. As part of oral evidence to the Inquiry the then Head of Energy Division, Fiona Hepper, stated that the level of interaction between Ofgem and DETI that existed at the time was considered to be sufficient to fulfil the role of any such formally constituted Administration Board (**TRA-02358** to **TRA-02359**). The Department does not consider that the informal arrangements described are equivalent to the structure of a formally constituted Board, which would have had explicit responsibility for oversight and project management of the development and implementation of the Scheme. Indeed, the informality of these arrangements meant that meetings were not held regularly over the life of the Scheme, particularly as staff changes occurred within DETI, and the Department considers that the lack of formal governance structures made interaction with Ofgem on Scheme implementation unnecessarily complicated.

11. Self-evidently, there was, from the outset of the NI RHI Scheme, a significant disparity between DETI’s experience in dealing with an RHI scheme, and the experience which Ofgem had gained from its work with the GB RHI. The Department considers that there is contemporaneous evidence which indicates

the Department's reliance on Ofgem, and Ofgem's greater experience of RHI type schemes. This is apparent from, for example, a letter from Fiona Hepper, head of DETI Energy Division to Gareth Atkins, head of implementation for RHI at Ofgem, dated 11 July 2011 (**OFG-01734**):

"Ofgem's experience in developing and implementing the RHI in Great Britain will be invaluable in the administration of the Northern Ireland Scheme given the many similarities between the two incentive measures."

This letter was sent prior to Ofgem developing a feasibility study for the Scheme.

12. There is also evidence which suggests that Ofgem was not only aware of this reliance, but indeed actively promoted its experience to the Department. In August 2011, in response to DETI's request for a feasibility study proposal, Ofgem produced a document entitled *Northern Ireland Renewable Heat Incentive: Initial Delivery Proposal* (**OFG-162032**). In the Executive Summary (**OFG-162032**) Ofgem highlight to DETI that:

"Ofgem E-Serve is pleased to respond to the request from the Department of Enterprise, Trade and Investment (DETI) to put forward a proposal for a feasibility study on developing and operating the Northern Ireland Renewable Heat Incentive (NIRHI). With our track record of successfully administering environmental and social programmes for government, including the GB Renewable Heat Incentive, we aim to use our expertise and experience to provide excellent value for money in meeting your requirements."

13. On 16 December 2011 Ofgem provided DETI with a feasibility study for the development and implementation of the Northern Ireland Renewable Heat Incentive (**OFG-125997** to **OFG-126149**). The purpose of the feasibility study (**OFG-126002**) is to:

"provide DETI and Ofgem senior management with a detailed understanding of the delivery and ongoing administrative implications of the scheme for Ofgem. This includes an analysis of costs, delivery options, risks and enforcement requirements."

The Department considers that this is a useful illustration of the dynamics of the DETI-Ofgem relationship in the early years of the NI RHI Scheme. Ofgem had experience, knowledge and resources which DETI did not itself possess, and DETI relied on Ofgem to provide “*detailed understanding*”, “*analysis*” of “*risks*” and “*enforcement requirements*”, and generally to share the benefits of its knowledge and experience with DETI.

14. Ofgem’s added value, beyond cost savings, in administering the GB scheme is stated again at paragraph 4.30 (**OFG-126031**) of the Feasibility Study, Ofgem’s:

“... approach will benefit from the development work of GB RHI and provide a system that will ensure security of information, minimise fraud risks and human error and provide administrative efficiencies while providing the most cost effective solution to meet the specific needs of the NI RHI”.

15. Communications within Ofgem around the time of the feasibility study’s development suggest that Ofgem’s own view of its role within the NIRHI scheme went beyond purely mechanical administration. Paragraph 112 of Dermot Nolan’s statement (**WIT-95041**) states:

“Email exchanges around the date of that January meeting reflectthe belief that Ofgem would add value in terms of addressing fraud and “gaming””

16. In the Department’s view, Ofgem’s contribution to the NI RHI Scheme was substantive and qualitative, incorporating analysis, scrutiny, understanding, communication to DETI etc., and exceeds the sometimes narrow descriptions of Ofgem’s role which have at times been placed before the Inquiry.

Ofgem communication with DETI

17. The theme of the adequacy, or otherwise, of the communication between Ofgem and DETI runs throughout the evidence provided to the Inquiry, and overlaps with

other key themes relevant to the Inquiry's work. The Panel and Inquiry Counsel have already explored a significant volume of material which illustrates the nature and extent of the communication between Ofgem and DETI. The Department does not propose to analyse forensically each contact between Ofgem and the Department in order to assess the adequacy or otherwise of the communication. The Department recognises that such an exercise is unlikely to be useful to the Inquiry. Instead, the Department intends to highlight particular instances where it has concerns about the quality or extent of the communication with the Department. It is obviously extremely difficult to assess what difference better communication would have made at key points, and the Department will not trespass upon matters which are properly left to the Inquiry.

18. When considering Ofgem-DETI communication, a good starting point is the administrative arrangements agreement signed in 2012 (**WIT-28706**). The agreement lists GEMA's responsibilities at clause 3. Clause 3.2(e) provides that one of the 8 things GEMA will do is to:

“take all reasonable steps to ensure that wherever possible it will facilitate the ability of DETI to operate effectively in relation to the Regulations. This may mean providing briefing or attending meetings with industry, providing resources are available to do this. GEMA will communicate with DETI on matters of common interest and common concern as appropriate”.

19. Clause 5.2 of the administrative arrangements (**WIT-28710**) states:

“Where either Party becomes aware of any actual or proposed amendments to or re-enactments of the Regulations or the Guidance, or that there is a need to effect such amendments or re-enactments, it will be responsible for informing the other Party as soon as reasonably practicable.”

20. Edmund Ward's evidence was to the effect that the requirement to communicate, enshrined in the administrative arrangements, simply echoed what he understood to be a normal part of good governance (Transcript Day 47 P.81):

“ Being a civil servant I would expect, if I’d come across something which needs to be addressed, then I would seek to address that and if something was to do with the Northern Ireland scheme, my default approach to that would have been, “Well, there is a contact point for the Northern Ireland scheme so I will talk to them about it”. So I don’t think it was with reference to the arrangements. It was just in line with normal...”

Edmund Ward also accepted that *“it’s incumbent on Ofgem to raise issues when it sees them”* (Transcript Day 47 P.78).

21. The Department sought to avail of Ofgem’s experience of working on the GB RHI Scheme. It is clear that Ofgem had significant engagement with DECC and it seems from Matthew Harnack’s internal email of 7 March 2012 (**OFG-77100** to **OFG-77101**) that by that date Ofgem was well informed as to the Phase 2 changes which DECC intended to introduce to the GB RHI Scheme, including interim cost controls, depression etc. The Department is not aware of any evidence that Ofgem took any steps, at this stage, to alert the Department to the proposed changes. The Department fully accepts that it may have also been possible for the Department to proactively obtain information directly, from DECC, and also notes the subsequent public consultation which addressed some of this material in late March 2012. However, as a matter of principle, the Department would have expected, given that Ofgem had recently completed a feasibility study for the Department to which these proposed changes would be directly relevant, and given that Ofgem was awaiting confirmation that it would act as the administrator of the NI RHI Scheme, that Ofgem might have contacted DETI to provide advance warning in a spirit of co-operation and openness.

22. Ofgem’s corporate evidence has been to the effect that, certainly during the operational stage, Ofgem’s role was very narrow - Ofgem administered the NI RHI Scheme and reported the information which the Arrangements required it to report. However, the Department would have expected that, as part of its role in administering the NI RHI Scheme Ofgem would also have been communicating closely with DETI to share its experience and learning from the GB RHI Scheme.

23. There is not unanimity, within the Ofgem evidence, as to the adequacy of Ofgem's communication with DETI. Dermot Nolan's stance (**WIT-95068**) can be contrasted with that of Frances Hale, a former member of Ofgem staff, who is critical of the lack of assistance Ofgem gave DETI (**WIT-102911**):

"In my view the NI Regulations were lacking when compared to the GB Regulations....Responsibility for policy lay with DETI, though in my view the Senior Management team could have done more (given their knowledge of the GB scheme) to highlight this point to the team at DETI"

The Department fully accepts that the question of whether Ofgem should have been more proactive in warning DETI of lessons learnt from the operation of the GB RHI Scheme is a matter for the Panel to determine.

24. The Department is concerned that, at times during the progress of the NI RHI Scheme, opportunities for learning may have been lost as a result of the level of communication from Ofgem. Emails from Alastair Nicol, a consultant working for Invest NI, to Edmund Ward dated 15 August 2013, demonstrate that Ofgem should have been aware of the potential for gaming from relatively early on in the Scheme's operation. In his email to Edmund Ward (**OFG-164265**), Alastair Nicol states:

"I seek some urgent advice on the interpretation of the RHI as applied in Northern Ireland. We work for a quasi-Governmental Organisation in Northern Ireland and in one particular project they are adamant a multiple boiler solution may be used to maximise RHI benefits. This is at odds with my reading and understanding but perhaps you or Jacqui could consider and clarify. The situation is probably best summarised by the three cases below – I've exaggerated the values to illustrate the case clearly. The question is one of aggregation. Would you be kind enough to advise."

25. Alastair Nicol proceeded to provide Edmund Ward with three case studies and asks for confirmation that the boilers in question will attract individual tariffs, despite the fact that they heat the same building or service aggregated site demand, by merit of the fact that they were not hydraulically linked. (**OFG-164265**). The Department is unaware of any record of an e-mail response from

Edmund Ward to Alastair Nicol or other internal response from Ofgem to address his concerns, however it appears that Alastair Nicol's email set off a flurry of activity within Ofgem. There is a follow up email from Alastair Nichol to Jacqueline Balian on the same day, asking for her help as he believes Edmund Ward is on holiday. Jacqueline Balian asks Mark George to have a look, also on the same day (**OFG-164264**). He replies "*FYI – Edmund has now spoken to Alastair and answered all his questions*". None of this activity seems to have been relayed to DETI, as far as the Department has been able to discern.

26. Similarly, in November 2013 the "*Ofgem RHI team*" appear to have received a presentation from Ricardo-AEA about "*RHI Auditing*" (**OFG-87862**). The Agenda suggests that this was scheduled to last for 1.5 hours (**OFG-87862**). Ricardo-AEA provide an overview of RHI auditing, and give a number of specific examples, including one in Herefordshire under the heading "*Challenging audits*", (**OFG-87874**). It is recorded:

- *Participant has hydraulically separated heating system*
- *Multiple boilers heating same space*
- *External heat losses*
- *Participant's own records indicate a higher heat output than stated on boiler nameplate.*
- *Authorised signatory is also system designer*".

27. Ricardo-AEA clearly set out the gaming issues apparent from this example. It is illustrated with a large photograph of the "*open (permanently)*" shed, which essentially appears to have open gaps in place of windows and doors. It also records:

"Wider implications:

- *Example of a participant reading the guidance documentation and identifying loopholes*
- *Policy development, this installation is an example of a system designed to maximise RHI benefits, [it] would not have been designed this way without RHI."*

28. Elsewhere in the same presentation (**OFG-87878**) it is identified that there are:

“Several examples where participants are drying biomass to be used in RHI installations and claiming RHI on the heat used for drying”.

Ricardo-AEA give examples of types of installations that are permitted under the current Regulations, and suggest a potential definition of useful heat (**OFG-87879**). The presentation also contains a “*Policy: Multiple Installations*” section (**OFG-87882**):

“A number of unintended developments have been encountered through RHI audits

-Multiple <200kWth systems are being installed on the same site to maximise RHI payments i.e. poultry sheds

– System design is geared towards decentralised heating systems

– Example of heating system being hydraulically separated but feeding same heating unit

These above issues represent a significant financial cost to the programme in terms of RHI payments. Also represent burden (increased costs) to Ofgem administration.”

Ricardo-AEA then proceeded to outline a number of recommended changes.

29. The above Ricardo-AEA presentation to Ofgem appears to have occurred in November 2013, at a relatively early stage in the NI RHI Scheme. It is clearly a prescient document in terms of the issues that materialised during the operation of the NI RHI Scheme. The Department is unaware of any evidence to suggest that this document, or any examples drawn from it, were ever provided to DETI. Equally, the Department is unaware of any evidence that later Ricardo reports, which also addressed NI RHI Scheme site audits (e.g. **OFG-59031**), were ever provided to DETI. This is despite the agreement in the administrative arrangements agreement that “*Upon completion of the audits, Ofgem will share the outcomes where they relate to the NI RHI.*” The Department considers that the failure to provide these documents constitutes a loss of opportunity for DETI to understand the gaming that was actually occurring and that was being recorded as occurring in the GB RHI Scheme. The question of fraud is also dealt

with in a separate section of this statement, but the above example is equally relevant to the question of Ofgem-DETI communication.

30. The Department also has concerns about Ofgem's general approach to communication with DETI, after understanding more about the team structures within Ofgem from the evidence of Gareth John (Transcript Day 62). Gareth John joined Ofgem in January 2014, at which time he had 90 staff members working under him dealing collectively with the NI and GB RHI Schemes (Transcript Day 62 P.11-12). The manpower resource which Ofgem was able to devote to the RHI Schemes stands in stark contrast to the resource which DETI had at its disposal.
31. In terms of his own awareness of gaming issues, Gareth John indicated that "*at some point in 2014 – probably the middle of 2014*" (Transcript Day 62 P.12) he became aware of gaming issues in the GB RHI Scheme. This evidence raises two separate issues in terms of the quality of communication in respect of RHI. Firstly, Gareth John had been in post since January 2014, Ofgem were aware of gaming issues in the GB RHI Scheme before he arrived, and yet Gareth John had no knowledge of the problem until the middle of the year, so obviously, could not pass on to DETI that which he did not know himself. The second issue is that, even if his team had earlier knowledge of potential gaming in the GB RHI Scheme, Gareth John's evidence is that although he himself knew of the issue by mid 2014, he does not suggest that the question of gaming was raised with or highlighted to DETI at that time.
32. In his oral evidence (Transcript Day 62 P.17-18), Gareth John accepted that there was a policy development team under him, which advised both DECC and DETI on policy. While he sought to draw a distinction between advice on policy matters and advice on implementation of policy, Gareth John was nonetheless clear in his evidence (Transcript Day 62 P.18) that "*if observations were made they'd be raised and communicated*" to DETI.

33. Gareth John was also able to inform the Inquiry that effectively the same team, under his management, worked on both the NI and GB RHI Schemes. He explained:

“...There may be some specialist personnel that understood the differences in both schemes, but on a day-to-day basis or a week-to-week basis there will be, you know, the vast majority — maybe 80% — will be, you know, will be dealing with both — with both schemes...”

Two concerns for the Department arise out of the above statement. The first is that, while 80% of the Ofgem staff worked on both the NI and GB RHI Schemes, there were only *“some specialist personnel that understood the differences in both schemes”*. The Department does not, at present, understand how some basic awareness of the key differences between the two schemes would not have been a requirement for any personnel dealing with both schemes. Secondly, if the vast majority of Ofgem staff were working on both schemes, and if there was an awareness within Ofgem of gaming issues in GB and the likelihood of similar issues in the other scheme which they were administering (NI), it is difficult to understand why an ‘observation’ was not raised and passed on to DETI in the way presumably envisaged in paragraph 32 above.

34. On 17th June 2015, Edmund Ward of Ofgem sent an internal email (**OFG-32592**), dealing with, amongst other things, DETI’s request to pause applications, given the budget issues with the NI RHI Scheme. Edmund Ward reports that he responded to DETI’s request in the following way:

“I suggested we would look at the numbers and revert informally on whether it could be possible to prioritise applications submitted before 31 March 2015 for a few weeks? [NB: A more rigorous approach to not properly made applications was not mentioned]” (OFG-32593).

If the Department’s understanding of this email is correct, it suggests that Edmund Ward considered there were at least two possible responses to the difficulty faced by DETI. One option was to prioritise applications submitted before the 31 March 2015, which Edmund Ward claimed he raised with DETI. The other option was to take a more rigorous approach to applications which

were considered to have not been ‘properly made’, which he asserted “was not mentioned”. The implication is that Edmund Ward was aware of this possible option but did not raise it with DETI. The Department suggests that two issues remain to be determined in this regard. Firstly, whether this implies a lack of rigor in Ofgem’s usual approach to improperly made applications, and whether Ofgem advised DETI of this less than rigorous approach. Secondly, whether Edmund Ward should have raised the option of taking a more rigorous approach with DETI, rather than merely discussing it internally, in Ofgem.

35. The Department accepts that the absence of the joint DETI-Ofgem Board, which had initially been envisaged, represented a loss of opportunity for more formalised and scheduled communication between DETI and Ofgem.

Risk Management

36. The NI RHI Scheme, like the GB RHI Scheme, was novel, demand led, and involved a significant financial commitment of taxpayer money. There was a clear need for appropriate risk management. The Department relied upon Ofgem’s assistance in managing risk at both the development and operational stages of the NI RHI. In the development stage, the Ofgem feasibility study was intended to involve an assessment of risks, but the planned independent risk assessment never ultimately took place. In terms of the operational stage, at paragraph 245 (**WIT-95072**) of his statement, Dermot Nolan asserts:

“Ofgem is responsible for operational aspects of the NI RHI scheme and this is reflected in our management of risks.”

37. The Department questions whether Ofgem adequately approached the management of issues and risks throughout the lifetime of the Scheme, given Ofgem’s knowledge and experience, including its experience of the GB RHI Scheme and the GB FIT Scheme.

38. Several Ofgem staff members have given oral evidence to the Inquiry, and still more have provided written statements. The Department is concerned that the

evidence appears to show a lack of internal cohesion, within Ofgem, in terms of the level and transfer of knowledge about the NI RHI Scheme and any associated risks.

- a. Martin Crouch (**WIT-100514**), Acting Deputy Managing Director of E-serve between 2013 and 2014, stated that he was aware of the risk of overcompensation that accompanies schemes which follow the same model as the NI RHI. To this end he confirmed (at paragraph 19) that *“I believe that I was aware that the NIRHI scheme (as the GB Scheme) was intended to provide a subsidy for capital costs based on a payment for heat produced and that this could give rise to particular incentives on operators such as to maximise heat produced. I understood that the complicated processes in the scheme were, in part, intended to respond to and address these issues”*.
- b. Kevin Hughes began working on the NI RHI Scheme in February 2016, and his level of understanding was expressed in the following terms (**WIT-100718** paragraph 19): *“When I started my QC training in February 2016 on NI applications, I asked whether there were any cost controls in place, similar to the GB RHI scheme, and was informed that there was no tier tariff structure in place nor any other financial cap. It was at this time when I became aware that there was a possible incentive in some cases to produce heat merely to make a profit from the Scheme.”*
- c. Mark Tischler, who worked as a Data and Information Manager on the RHI scheme, confirms (**WIT-102617**) *“When I joined Ofgem in 2014 I was aware the subsidies rates on the NIRHI scheme were higher than the cost of fuel as the scheme was set up as an incentive to subsidise the initial outlay of the boiler installation and therefore this would be required. I am not sure when I first heard of rumours of installations which were producing heat for the sole purpose of profit but this was likely to be within my first year in 2015 from other colleagues”*.

39. Catherine McArthur has acknowledged, in both her oral evidence (Transcript Day 28 P.76) and her written witness statement (**WIT-101328**) that DETI was

“concerned” about cost controls in the NI RHI Scheme, in the context of the early stages of the development of the Scheme.

40. Keith Avis, from April 2012 was the Senior Manager covering the NI RHI scheme within E-Serve. From April 2012 to February 2013, he had responsibility for the team that put in place the necessary procedures for the RHI scheme’s operation in NI (**WIT-102323** to **WIT-102324**):

“I was involved at the development phase of the NI RHI Scheme. The DETI proposals concerning the NI RHI Scheme were reviewed by Ofgem, including by its legal team, and deemed appropriate to enable operational processes to be framed to reflect the detail. I left the NIRHI team at the end of the development phase in February 2013, so cannot comment on any issues that may have manifested themselves during the operation of the NI RHI scheme.”

41. The minutes of a meeting held within Ofgem on 22 May 2012 to review the NI RHI Feasibility Study, and at which Keith Avis was in attendance, confirms the fact that the key personnel from Ofgem were unaware of whether the warnings had been provided to DETI in relation to the regulations (**OFG-133084**). At paragraph 3 therein, it states:

“At the end of last year Ofgem legal produced a table of corrective amendments which it considered desirable. They mentioned that they passed this onto new schemes development team. It is unclear whether DETI have even had sight of this table, still less taken it into account in preparing the latest draft of the NI Regulations, though it is believed that was the intention at the time it was prepared. Keith Avis took away a commitment to establish whether the table was shared with DETI. It was also believed that Catherine MacArthur had written to DETI in November last year setting out the options as regards reflecting the GB legislation and Keith undertook to check this too”.

42. This lack of internal coherence of corporate knowledge connected to the NI RHI Scheme within Ofgem is a cause of concern to the Department. The minutes of the meeting on 22 May 2012 also reflect that Ofgem recognised a responsibility

to communicate risks with DETI, in an advisory capacity (**OFG-33084**). See paragraph 4:

“In the same connection it was observed that if it transpired that DETI are unaware of the current shortcomings with regard to the GB regulations it was not clear how we could responsibly keep the information from them”.

43. The importance of identifying risks during the development stage was recognised by the Department, and it was intended that this would form part of the feasibility study exercise. It is clear from the feasibility study that the intent was to carry out an independent risk assessment. However, DETI and Ofgem agreed to defer the completion of the risk review. The rationale given for this deferral was that it would more accurately reflect the risks associated with the divergence from the GB Scheme (**OFG-126019**). The feasibility study explained that until the NI RHI specific risk assessment was completed, Ofgem would proceed on the assumption that the risk of fraud for the NI scheme was the same as that for the GB Scheme.

44. The independent risk assessment on the NI RHI Scheme was never carried out by Ofgem, a failing that is compounded by the fact that the problems in the NI scheme were largely attributable to its continued divergence from the GB Scheme in relation to cost controls and tariff levels.

Fraud and Compliance

45. The evidence provided to the Inquiry has raised a number of concerns for the Department as to the adequacy of the fraud prevention procedures utilised by Ofgem in the context of the NI RHI. The Department is particularly troubled by:

- a) The absence of a separate fraud prevention risk register for the NI RHI Scheme
- b) The absence of a separate fraud prevention strategy for the NI RHI Scheme
- c) The reactive nature of the counter fraud team in addressing issues with the NI RHI Scheme

- d) The stark contrast between the procedures now adopted by Ofgem, and those in place during the development and operation of the NI RHI Scheme in the time period considered by the Inquiry.

46. In the Feasibility Study that Ofgem provided to DETI, the proposed approach to fraud prevention is depicted as proactive. In para 1.31 of the Feasibility Study, Ofgem promotes the importance of the Central Register that would hold key data relating to all NI RHI installations. Ofgem asserted that this would allow audit checks to be carried out on all generation data, including:

“trend analysis reporting on the data contained in the Central Register to identify suspicious activity”.

47. On 17 October 2011, Catherine McArthur e-mailed herself a document entitled “Periodic Information” (**OFG-170360** to **OFG-170363**), which appears to be part of a suite of materials on feasibility. In addressing the controls in place relating to the monitoring of compliance, Ofgem noted that the *“submission of this information (periodic data etc.) will also trigger a review process that will flag any inconsistencies or suspicious activity, such as where the meter reading is higher than possible heat generated by the technology or capacity of the system installed or where meter readings are regularly round numbers”* (**OFG-170360**). To the Department, the utility of this control was undermined by the fact that applicants were stating projected operational hours for their RHI installations at 100%. Nonetheless, it also appears that those participants who stated their projected operational hours at 100% did not trigger a suspicious activity alert with Ofgem.

48. Ofgem held a fraud prevention strategy document, and a fraud prevention risk register, which for the key years of the NI RHI Scheme, purported to deal collectively with both the NI and GB RHI Schemes. The fraud prevention strategy risk register is essentially a spreadsheet of which there are several iterations. The document dated 12 September 2012 specifically refers to the risk that *“participants may install multiple small installations in order to benefit from higher tariff rates.”* It states that the mitigant for that risk is *“For multiple units of the same technology installed on a single site, the combined heat capacity will be*

considered for RHI purposes.” (OFG-134921). The document entitled “New Format RHI Scheme Risk Register”, dated 27 November 2013 (OFG-134930) again raises the problem of multiple boilers, this time under the headline “*gaming opportunities*”, but this time there is no mitigation provided at all. The Department is not aware of any evidence to suggest that Ofgem notified DETI that this mitigation measure for dealing with multiple boilers had been removed.

49. The 27 November 2013 risk register (OFG-134930) does contain the following mitigation measure, in terms of the gaming group of activities generally:

“Tiered tariff for biomass (a higher tariff rate is paid for the first 15% of annual heat generation hours) reduces the incentive to purposefully generate then waste heat.”

This is obviously incorrect as a mitigation measure in respect of the NI RHI Scheme, which did not have tiering. The document appears to contain references to specific provisions within the GB Regulations but does not contain corresponding references for NI, despite the fact that it purports to be a risk register for both the GB and NI RHI Schemes

50. Gareth John’s oral evidence (Transcript Day 62 P.86) was that, at least from the time when he joined Ofgem, these registers would be reviewed monthly by the Ofgem team, with the named Ofgem risk holder. There would then be “*a roll up and a report*” to the fraud management group, later the risk and fraud management group, “*where those would be discussed and also, from my recollection, from a combined risk register point of view, be discussed at the implementation board in terms of those risks and, then, at the risk and fraud management group. From time to time, there’d be a further drill down in terms of the detail. So the highest-level risk would get rolled up, but then there’d be a further drill down, so there’d be regular review.*” The Department is not aware of any evidence to suggest that, as a result of any such review by Ofgem, DETI was notified that a) the previous mitigation measure for dealing with multiple boilers had been removed and there was now no mitigation measure or b) that a mitigation measure for gaming, based on tiering, was being relied upon even though the NI RHI Scheme did not have tiering.

51. In a similar vein, the December 2013 Fraud Prevention Strategy, at section 7.3 (**OFG-88523**) replicates the reference to tiering as a mitigant, even though the NI RHI Scheme had no tiering. Gareth John's oral evidence (Transcript Day 62 P.95-96) was to the effect that, for the purposes of site audit, he would expect the checklists being used by the subcontractors to reflect the mitigation recorded in the risk register. The Department suggests that the Inquiry should determine the appropriateness of this in a Northern Ireland context where the mitigant did not apply.

52. The fraud prevention strategy from December 2013 (**OFG-88523**), in the context of gaming opportunities, refers to:

“Over sizing of boilers to ensure high proportion of heat is generated at a higher tariff rate; under sizing of boilers/installing multiple separate boilers in order to maximise the applicable tariff rate.”

Tiering is again referred to as a mitigant in respect of this risk, despite being non-existent in the NI RHI Scheme. The document continues,

“At present no remedy is available within the RHI regulations to address the issue of over/under sizing of boilers. Information has been provided to DECC and consideration is being given to regulatory amendments.”

53. The Department is concerned that the impression given by successive fraud prevention strategies and fraud risk registers, all of which were apparently subject to regular review, amendment and scrutiny by a wide range of Ofgem personnel, is that, for a significant period of time, fraud risks were really only considered by Ofgem in the context of the GB RHI Scheme and the GB Regulations. The Department is concerned that insufficient attention may have been given to the differences between the NI RHI Scheme and the GB RHI Scheme, in the context of risk.

54. The Department is not aware of any evidence to suggest that the fraud prevention strategy operated by Ofgem was ever shared with DETI prior to it

being incorporated as an annex to a feasibility study in summer 2015. The Department is unaware of any reasoned basis on which the Department's administrator of the NI RHI Scheme should have withheld the detail of its fraud prevention strategy from DETI. It is impossible now to accurately assess what would have happened if this document (in any of its iterations) had in fact been shared with DETI. However, the Department considers that the failure to share this important document constitutes a missed opportunity for DETI to realise that the gaming opportunities, in the context of the NI RHI Scheme, were not being mitigated in the manner intended.

55. At paragraph 185 of Ofgem's opening statement, Jason Beer QC reiterated Ofgem's approach to its level of responsibility. In summary, a) Ofgem warned DETI of the issues in advance of the adoption of the NI RHI Scheme but DETI nonetheless chose to proceed and b) Ofgem reminded the Department of these issues separately as they arose. The Department considers:

- a. Notwithstanding Ofgem's statement that it had provided DETI with comments on the draft regulations, this cannot be presented as a substitute for either a robust compliance approach or the implementation of an effective fraud prevention strategy;
- b. Enforcement of the Regulations is not, in itself, sufficient to fulfil Ofgem's responsibilities as to fraud prevention in relation to the NIRHI Scheme;
- c. In fact, the clear institutional knowledge that Ofgem had of the fraud risks inherent in the NI RHI Scheme suggests that this should have informed their Fraud Strategy and management controls.

56. It is clear that not only did Ofgem's Fraud Strategy in relation to the NI RHI Scheme fail to reflect the issues and risks highlighted in the memo of November 2011, it did not reflect concerns that appeared to be known to Ofgem staff at the time, as has been noted above.

57. It appears that Ofgem's fraud and compliance team failed to take account of a number of further issues insofar as it considered site auditing, evidenced in the documents before the Inquiry, including:

- a. Dermot Nolan notes, at paragraph 383 of his statement (**WIT-95106**), that on 19 October 2015 Stuart Wightman of DETI sent Edmund Ward of Ofgem a letter informing him that the Department had heard anecdotal evidence of “gaming” (**WIT-95106**). In response, Mr Nolan notes that money was made available for additional site audits, and indeed was aware that DETI had previously sought increased auditing and inspection (**OFG-10792**) demonstrated in an e-mail of 28 November 2012 from Matthew Harnack to Robert Hull, but there is no evidence that the Ofgem approach to site auditing or the compliance and counter-fraud strategies were amended to take account of this information. There appears to be no evidence from Ofgem as to whether it reviewed its processes and procedures to identify how the anecdotal evidence of 19 October 2015 was not also discovered internally.
- b. On 26 April 2016, Ofgem received an email (**OFG-150851**) from a member of the public to its generic whistleblowing mailbox alleging that beneficiaries on the GB RHI Scheme in the poultry industry were deliberately “dumping” heat to generate payments. Although this whistleblowing related to the GB RHI Scheme, Ofgem should have realised that the risks in relation to fraud were not only also applicable to the NI RHI Scheme, but were on a proportionately greater scale because of the prevalence of poultry farms in Northern Ireland and the lack of cost controls on the NI RHI Scheme. The Department believes this is the kind of transferable knowledge that DETI could reasonably have expected to be applied to the NI RHI Scheme by Ofgem, by means of a fraud prevention strategy, at the least.

58. The reactive nature of the compliance function or counter-fraud team was accepted by Edmund Ward in his oral evidence to the Inquiry (Transcript Day 47 P.77-78). The more proactive impression, which was conveyed at the feasibility stage (see above) does not appear to have materialised in practice. Edmund Ward agreed that, in 2013 and 2014, Ofgem were not monitoring, analysing or reporting on the data that was being collected, in order to target or inform the counter fraud process (Transcript Day 47 P.78). The Department regards this as

unacceptable and considers that it constitutes a failure on the part of Ofgem to carry out appropriate administration of the Scheme.

59. Edmund Ward identifies 2015 as the year when Ofgem began to move to a more proactive approach based on data analytics, and he believes this change was ongoing at the time of the 2015 spike in applications (Transcript Day 47 P.78).

Comparison between Ofgem's work on the GB RHI Scheme on behalf of DECC, and its work on the NI RHI Scheme on behalf of DETI

60. The Department accepts that the NI RHI Scheme was a proportionally small part of the work which Ofgem was undertaking in relation to RHI, given the much larger size of the GB RHI Scheme. However, the Department is nonetheless of the view that the service provided by Ofgem to DETI should have been of the same standard as the service provided to DECC. The Department is concerned that some of the evidence elicited by the Inquiry calls that principle into question.

61. Matthew Harnack of Ofgem, who was associate director of new scheme development from mid-2011 to August 2013, made clear in his oral evidence (Transcript Day 29 P.9) that when Ofgem discussed becoming involved in the administration of the NI RHI Scheme, its focus was what benefit such involvement would bring to GB energy consumers (rather than any benefit to NI):

"Mr Harnack:...I think my only recollection, in general terms, was that the discussions that I was involved in were are there any benefits for GB consumers, why should Ofgem do this, what are the benefits to GB consumers, because Ofgem represents and looks after the interests of GB consumers. So, we put forward the case for the benefits to be able to answer that question."

While the Department would naturally welcome any benefits to GB energy consumers, the Department's focus in appointing Ofgem to administer the NI RHI Scheme was directed towards the benefits to NI, and NI consumers. The

Ofgem evidence on this point suggests that this primary goal was not shared by Ofgem.

62. The Department is also troubled by the revelation of internal Ofgem communications which suggest that NI was not a particularly high priority for Ofgem. The language of “*low priority*” is explicitly used in internal Ofgem communications. Richard Kayan of Ofgem sent an email to five Ofgem personnel on 1 August 2012 (**OFG-126516**), including Matthew Harnack, which appears to refer back to a discussion at a previous meeting:

“-I will refer to the EPB minutes from a month ago, where I believe it was specified that this was a ‘relatively low priority’ deliverable for E-Serve.

- I will look into why a BA was not allocated to this in July, when this was understood to be the agreement.”

The Department is not aware of any evidence that the low priority afforded to the NI RHI Scheme by Ofgem, or its characterization of the Scheme as “small fry” (**OFG-12531**) was brought to the attention of the DETI officials dealing with the NI RHI Scheme at the time.

63. This attitude towards the arrangements in NI does not seem to have been an isolated view. In February 2013 Matthew Harnack was emailed about the potential for Ofgem to administer a FIT scheme for NI (**OFG-12531**), and his reply indicated his current thinking in respect of NI:

“Bloody hell. Given the headaches we’ve had with NIRHI arrangements I would be reluctant to take on anything else for them (no offence to them of course, it’s just such small fry that it wasn’t worth the hassle and I couldn’t say that they’ll be getting the best VfM unless it’s a vanilla copy of GB FITs), though having said that running the FITs for them could be much better’ VfM than RHI as the volumes are a lot higher...”

64. Matthew Harnack was asked about this email in some detail by Inquiry Counsel in his oral evidence (Transcript Day 29 P.17-25), and he seems to suggest that the reference to “*small fry*” was based in some way on low take up of the NI RHI

Scheme. Ofgem was at all times aware that due to the population disparity between NI and GB, the NI RHI Scheme would be smaller. Ofgem was also undoubtedly aware that the initial uptake in GB was lower than expected, and the NI RHI Scheme subsequently echoed that trend. None of this should have come as a surprise to Ofgem. The Department does not understand, in this context, Matthew Harnack's explanations as to why the NI RHI Scheme was considered "*small fry*" and "*wasn't worth the hassle*".

65. A similar attitude to the NI RHI Scheme is arguably revealed in the 6 November 2011 email from Keith Avis, to other Ofgem colleagues, in which he remarked:

"I appreciate that the Northern Ireland renewable heat incentive was more of a petulant teenager than the cute baby brother of the GB regs."
(OFG-10183)

66. The language of internal Ofgem emails seems to reveal a view that the NI RHI Scheme was small and low priority compared to the GB RHI Scheme, and required more effort than Ofgem felt it was worth.

67. The Department sees a clear contrast between the nature of service that Ofgem claims it had responsibility to provide to DETI and that which was provided to DECC (later BEIS). The Department has previously commented above, that it does not accept that Ofgem acted purely in an administrative role in relation to the NI RHI Scheme. In a comparison of how comprehensive Ofgem's contribution to both Schemes was, it appears that Ofgem took a more proactive role in risk management and fraud prevention in the GB RHI scheme than was adopted in respect of the NI RHI Scheme.

68. Staff dealing with the NI RHI Scheme within Ofgem do not appear to have benefitted fully from work being done on the GB RHI Scheme, as is apparent from an email from Paul Heigl to Silvester Aina of 20 September 2012 **(OFG-163010)**:

*"Hi Silvester,
I just spoke to James Kerry about GB RHI potentially running a risk workshop with Deloitte on the Phase 11 work. Would you*

know when this might be planned for? We on the NI RHI development team would very much like to join your workshop and contribute to the cost (we have a measly £5K in the budget, but gotta be better than nothing I guess)...

Thanks,

Paul”

69. In a response to Paul Heigl's e-mail, on 21 September 2012, (**OFG-163064**) Silvester Aina pointed out that the risk workshop had already been held. Paul Heigl commented “*Oh...hmm... fuganything planned for Phase III?*”. Silvester Aina confirmed by return that a risk workshop was planned for Phase III. Paul Heigl asked “*would your best guess be that you might do it before 1 November this year?*” (**OFG-163064**). The above timeline suggests that Paul Heigl was anxious to ensure some work on risk management was completed before the launch of the Scheme and this had not been offered previously.

CONCLUSION

70. The Department acknowledged, at paragraph 4 of this supplementary statement, that responsibility for the design of the Northern Ireland non-domestic RHI scheme rested with DETI. However, the Department takes the view that in relation to the operation of the scheme, it was entitled to place a substantial degree of reliance on Ofgem, given its promotion of the experience it had in the delivery of the Renewable Heat Incentive Scheme in Great Britain. As referred to in paragraph 12 of this statement Ofgem had asserted: “*With our track record of successfully administering environmental and social programmes for government, including the GB Renewable Heat Incentive, we aim to use our expertise and experience to provide excellent value for money in meeting your requirements.*”

71. In conclusion, the Department, considers that there were areas, as outlined in this supplementary statement, where the service provided by Ofgem fell short of

those which the Department could reasonably expect another public body to provide.

Signed

Brendan McCann

Date

21 September 2018